89-54

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

NCR CORPORATION,

Petitioner,

v.

COMMISSIONER OF REVENUE,
of Minnesota

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

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QUESTION PRESENTED

Whether Minnesota's inclusion in Petitioner's apportionable income of the foreign-source dividends, interest, and royalties paid to Petitioner by its unitary foreign subsidiaries, without a correlative adjustment of the apportionment formula to reflect the property, payroll, and sales of the payor foreign subsidiaries, contravenes the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article I, Section 8, of the United States Constitution.

RULE 28.1 STATEMENT

This Petition for a Writ of Certiorari is filed on behalf of Petitioner, NCR Corporation. Petitioner's subsidiaries (other than wholly-owned subsidiaries) and affiliates are:

NCR (Bahrain) W.L.L.
Drescher-NCR Druck G.m.b.H.
NCR Japan, Ltd.
NCR Industrial de Mexico, S.A. de C.V.
NCR (Nigeria) Limited
Business Machines Limited
NCR Ghana Limited
Regis Court Management (Marylebone) Limited
Melcombe Court Management (Marylebone) Limited
NCR Gabon S.A.R.L.
SIGA-MEXICANA, S.A. de C.V.
NCR Nederland N.V.
NCR Corporation (Philippines)
NCR Bilgi Islem Sistemleri A.S.

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NCR CORPORATION,

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v.

COMMISSIONER OF REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

Petitioner, NCR Corporation, petitions for a writ of certiorari to review the judgment of the Minnesota Supreme Court in this case.

OPINIONS BELOW

The opinion of the Minnesota Supreme Court (App. A, 14a-32a)[1] is reported as *NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989). The opinion of the Minnesota Tax Court (App. A, 1a-13a) is not reported.

JURISDICTION

The judgment of the Minnesota Supreme Court was filed on February 24, 1989. App. A, 14a. A timely

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[1] "App." references are to the Appendix to this Petition.

petition for rehearing was denied on April 14, 1989. App. A, 33a. The jurisdiction of this Court is invoked under 28 U.S.C. §1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Constitutional provisions involved in this case are the Due Process Clause, U.S. Const. amend. XIV, §1 and the Commerce Clause, U.S. Const. art. I, §8, cl. 3. Amendment XIV, §1 of the Constitution provides in pertinent part that "No state shall . . . deprive any person of life, liberty, or property, without due process of law." Article I, §8 of the Constitution provides in pertinent part that "Congress shall have Power . . . [t]o regulate commerce with foreign Nations, and among the several States."

The case involves the constitutionality of Minn. Stat. §290.19 (1980), reprinted at App. C, 45a-47a.

STATEMENT OF THE CASE

Petitioner is incorporated under the laws of Maryland and has its corporate offices and principal place of business in Dayton, Ohio. Petitioner transacts business partly within and partly without Minnesota. During each of the five years in issue, 1977-1981, Petitioner maintained manufacturing and sales facilities in Minnesota. App. A, 2a, 15a.

Petitioner conducts business outside the United States through foreign branches and foreign subsidiaries. The activities of Petitioner and its foreign subsidiaries constitute a single unitary business involving the manufacture and sale of business machines and equipment. The unitary foreign subsidiaries

do not conduct any business within Minnesota. App. A, 2a, 15a.

Petitioner obtains and utilizes patents as a part of its ordinary business and, pursuant to patent licensing agreements, grants to its unitary foreign subsidiaries the rights to patents to manufacture and sell business machines and equipment. App. A, 2a, 15a. Petitioner also makes interest bearing loans to its unitary foreign subsidiaries. App. A, 2a.

For the years 1977 through 1981, it is stipulated that Petitioner received dividends, interest, and royalties from its unitary foreign subsidiaries in the following amounts (App. A, 2a):

Year	Dividends	Interest	Royalties
1977	$41,983,566	$3,197,520	$21,656,173
1978	41,931,362	5,852,927	19,466,545
1979	51,576,630	9,027,754	16,830,324
1980	61,583,067	15,325,626	28,462,939
1981	34,416,542	20,769,392	40,153,073

Petitioner paid approximately $41.5 million of withholding taxes with respect to these payments to the foreign countries in which the unitary foreign subsidiaries were organized.[2]

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[2] Petitioner's Minnesota Corporate Income Tax Returns for each of the years 1977 to 1981 ("1977-1981 Minnesota Returns") are part of the record. The amount of withholding tax paid by Petitioner was derived from the portions of the federal income tax returns that were attached to the Minnesota returns.

During the years in issue, Minn. Stat. §290.19 (App. C, 45a-47a) provided that a taxpayer doing business in Minnesota was required to file a Minnesota income tax return and apportion its income to Minnesota using the standard, three-factor apportionment formula. This formula attributes to Minnesota that fraction of a taxpayer's apportionable income that is the average of the ratios of a taxpayer's Minnesota property, payroll, and sales to the taxpayer's total property, payroll, and sales. Minn. Stat. §290.19, Subd. 1(1).

In filing its 1977-1981 Minnesota Returns, Petitioner included the income of its foreign branches in apportionable income and took into account the property, payroll, and sales of the foreign branches in computing the Minnesota apportionment fraction. Petitioner did not include any of the dividends, interest, and royalties received from its unitary foreign subsidiaries in apportionable income, and did not take into account any of the property, payroll, and sales of those unitary foreign subsidiaries in computing its apportionment fraction. App. A, 16a.

Petitioner's separate property, payroll, and sales reported on its 1977-1981 Minnesota Returns were:

Year	Property	Payroll	Sales
1977	$903,517,989	$495,930,079	$1,472,346,921
1978	781,776,129	502,163,328	1,705,427,111
1979	893,997,926	547,383,221	1,782,715,639
1980	1,027,484,700	636,038,449	1,826,884,242
1981	1,027,192,393	711,784,731	2,006,933,599

Petitioner represented in the proceedings below that, for the years 1977 through 1981, the aggregate property, payroll, and sales of its unitary foreign subsidiaries were (App. A, 3a):

Year	Property	Payroll	Sales
1977	$572,151,937	$245,614,128	$784,563,576
1978	585,423,054	235,891,484	733,390,600
1979	679,024,091	305,273,740	920,776,019
1980	904,220,615	439,517,670	1,336,081,709
1981	1,039,846,133	424,380,977	1,280,299,312

On audit, the Minnesota Commissioner of Revenue ("Commissioner") included the dividends, interest, and royalties Petitioner received from its unitary foreign subsidiaries in apportionable income without any reflection of the property, payroll, and sales of the unitary foreign subsidiaries in the apportionment fraction. App. A, 16a. This approach, the validity of which is at issue in this case, is sometimes hereinafter referred to as the "Minnesota apportionment formula." Petitioner's apportionable income, as adjusted by the Commissioner, and the aggregate amount of dividends, interest, and royalties received by Petitioner from its unitary foreign subsidiaries and included in apportionable income, were (App. A, 2a-3a):[3]

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[3] Under the Minnesota statute, Petitioner's apportionable income included 100 percent of the dividends received. After the income was apportioned, the amount of foreign-source dividends included in Petitioner's Minnesota taxable income was reduced by 85 percent. Minn. Stat. §290.21, Subd. 4. Accordingly, the apportionable income figures shown in the table include 100 percent of the dividends Petitioner received from its unitary foreign subsidiaries.

Year	Apportionable Income	Portion Attributable to Dividends, Interest, and Royalties
1977	$131,514,040	$66,837,259
1978	278,240,145	67,250,834
1979	299,499,453	77,434,708
1980	186,791,768	105,371,632
1981	168,347,373	95,339,007

By Notice dated September 21, 1984, the Commissioner increased Petitioner's tax liability for the years in issue by the aggregate amount of $216,053.94. App. B, 36a. Petitioner paid the additional tax plus interest and filed an appeal to the Minnesota Tax Court, objecting to the inclusion of foreign dividends and royalties in its apportionable income, and, in the alternative, to the exclusion of the property, payroll, and sales of the unitary foreign subsidiaries from the calculation of the apportionment fraction. App. B, 40a.

Before the Minnesota Tax Court, Petitioner advanced the statutory argument that the Commissioner was required under Minn. Stat. §290.19, Subd. 1(1) to reflect the property, payroll, and sales of Petitioner's unitary foreign subsidiaries in the denominator of the apportionment fraction. Br. at 7-9.[4] In addition, Petitioner argued that if the dividends, interest, and royalties it received from the unitary foreign subsidiaries are includable in apportionable income, then the Due Process and Commerce Clauses of the United States Constitution require the inclusion of the unitary foreign subsidiaries' property, payroll,

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[4] "Br." references are to the Petitioner's brief in the Minnesota Tax Court. "Pet. Reh." references are to Petitioner's Petition for Rehearing in the Minnesota Supreme Court.

and sales in the denominator of the apportionment fraction. Br. at 4-7, 9-11.

The Tax Court, in its Memorandum accompanying its Findings of Fact, Conclusions of Law and Order for Judgment, dated March 8, 1988, rejected Petitioner's statutory argument, stating (App. A, 5a) that Minn. Stat. §290.19, Subd. 1(1)(a) apportioned income "without reference to the factors of any foreign subsidiary corporations." The Minnesota Tax Court also concluded that Minnesota was not required by the Due Process and Commerce Clauses of the United States Constitution to reflect the property, payroll, and sales of Petitioner's unitary foreign subsidiaries in the denominator of the apportionment fraction. The court reasoned that this was not necessary because Minnesota was not taxing directly the income of the unitary foreign subsidiaries. App. A, 9a.

Petitioner petitioned to the Minnesota Supreme Court on April 11, 1988 for a writ of certiorari. App. B, 41a. The issue raised by Petitioner both in its petition and before the Minnesota Supreme Court was whether Minnesota's inclusion in Petitioner's apportionable income of the foreign-source dividends, interest, and royalties paid to Petitioner by its unitary foreign subsidiaries, without a correlative adjustment to the apportionment formula to reflect the property, payroll, and sales of the foreign subsidiaries, contravened both Minn. Stat. §290.19, Subd. 1(1) and the Due Process and Commerce Clauses of the United States Constitution.[5]

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[5] The Tax Court stated (App. A, 11a) that the question whether the inclusion of interest in apportionable income required an

The Minnesota Supreme Court affirmed the judgment of the Tax Court and rejected Petitioner's statutory and constitutional arguments. App. A, 32a. In considering the internal consistency portion of Petitioner's Due Process and Commerce Clause argument, the Minnesota Supreme Court concluded (App. A, 25a-26a) that Petitioner "has not demonstrated that exclusion of the subsidiaries' income producing activities in the denominator of Minnesota's formula would result in more than all of its income being taxed," notwithstanding the court's acceptance of Petitioner's factual assertion that it paid foreign income taxes on payments received from its unitary foreign income subsidiaries. App. A, 25a. The court also rejected the Petitioner's external consistency argument. Claiming that it was relying on this Court's approach in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 183 (1983), for addressing the external consistency requirement, the court (i) accepted the Commissioner's assertion that the average

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adjustment to the apportionment formula was not at issue, since the inclusion of interest was not challenged in the notice of appeal from the Commissioner's order. However, Petitioner did request the inclusion of "all the property, payroll and sales of the foreign subsidiaries" in the apportionment formula if dividends were included in apportionable income. App. B, 40a. Further, the parties stipulated the amount of interest paid by the unitary foreign subsidiaries, and this amount was included in the Tax Court's Findings of Fact. App. A, 2a. Based on the foregoing, the issue whether the inclusion of interest, as well as dividends and royalties, required an adjustment of the apportionment formula to reflect the property, payroll, and sales of the unitary foreign subsidiaries was presented to the Minnesota Supreme Court. App. B, 43a. That court also noted that NCR did not challenge the inclusion of interest. App. A, 16a, n.1

percentage increase in Petitioner's taxes for the years at issue under the Minnesota apportionment formula was 23 percent, and (ii) concluded that this average percentage increase was "within the 'acceptable margin of error.' " App. A, 28a.

In response to Petitioner's argument under *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), that the Commerce Clause was violated, the court distinguished *Japan Line* on the ground that it involved property taxes. App. A, 30a. Further, the court reasoned that the risk of multiple taxation exists under any apportionment formula, and "a constitutional analysis does not require a state to apply a different formula simply because the risk *may* be lower." App. A, 30a-31a. The court also rejected Petitioner's argument that the Minnesota apportionment formula prevented the United States from speaking with one voice in the conduct of foreign affairs. App. A, 32a.

In its Petition for Rehearing to the Minnesota Supreme Court, Petitioner argued that it had demonstrated with certainty that exclusion of the unitary foreign subsidiaries' property, payroll, and sales from the Minnesota apportionment fraction inevitably results in more than all of Petitioner's income being subject to taxation in violation of the Due Process and Commerce Clauses. Pet. Reh. at 1-7. Petitioner did not reargue its contention that where, as here, the apportionment formula is conceptually flawed, the resulting percentage increase in the taxpayer's taxable income is irrelevant in applying the external consistency requirement of the Due Process and Commerce Clauses. Petitioner did contend, however, that the court erroneously applied the *Container*

methodology in computing the percentage distortion caused by the Commissioner's failure to reflect the property, payroll, and sales of the unitary foreign subsidiaries in the Minnesota apportionment fraction. Pet. Reh. at 8-12.[6] The Petition for Rehearing was denied without opinion. App. A, 33a.

REASONS FOR GRANTING THE PETITION

I. THIS CASE PRESENTS AN IMPORTANT QUESTION OF STATE TAXATION.

This case involves a substantial constitutional issue that this Court has not yet directly addressed: may a State include foreign-source dividends, interest, and royalties received from unitary foreign subsidiaries in the taxpayer's apportionable income without a correlative adjustment to the apportionment formula to reflect the property, payroll, and sales of the payor foreign subsidiaries. As discussed below, this issue was specifically identified and deliberately left unresolved by this Court in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). Furthermore, this issue, which affects many taxpayers in nearly every state and involves large amounts of income, has not been uniformly dealt with by state courts.

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[6] The Petition for Rehearing demonstrates that the Commissioner's methodology was different from the methodology employed by this Court in *Container*. The Petition also points out that application of the *Container* methodology raises a number of ancillary issues. However, as the Petition makes clear, even under the set of assumptions most favorable to the Commissioner, the average percentage distortion under the *Container* approach is 31 percent, not 23 percent as asserted by the Commissioner. Furthermore, on a year-by-year basis, the distortion is 40 percent or more in three of the five years and 50 percent in one year. Pet. Reh. at 8-12.

A. This Question Was Deliberately Left Unresolved by This Court in *Mobil*.

In *Mobil*, this Court held that a State could constitutionally include dividends paid by unitary foreign subsidiaries in the recipient corporation's apportionable income. However, because the issue had not been raised, this Court stated on three occasions that it was not considering whether the inclusion of such dividends in apportionable income without a further adjustment to the apportionment formula was constitutionally permissible. *Mobil*, 445 U.S. at 434, 441, n. 15, and 449. This case presents this question with respect to interest and royalties as well as dividends.

Mr. Justice Stevens, in his dissenting opinion in *Mobil* (445 U.S. at 449-462), addressed the merits of this issue and concluded that Vermont had failed to apportion fairly Mobil's dividend income from its unitary foreign subsidiaries because the State had not taken into account the subsidiaries' property, payroll, and sales that generated that income. Specifically, Mr. Justice Stevens concluded that the factors in the denominator of the apportionment formula had to be adjusted, stating (*Mobil*, 445 U.S. at 461):

> Unless the sales, payroll and property values connected with the production of income by the [dividend] payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

This issue also was specifically identified in *Container Corp. of America v. Franchise Tax Bd.*, 463

U.S. 159 (1983). In that case, this Court contrasted the worldwide, combined reporting method required by California (which eliminated from the U.S. corporation's income all payments from unitary foreign subsidiaries but included 100 percent of the income and factors of the foreign subsidiaries in the apportionment formula) with the approach used by Vermont in *Mobil* and Minnesota here (which includes payments from unitary foreign subsidiaries in the U.S. corporation's apportionable income but does not reflect those subsidiaries' property, payroll, and sales in the apportionment fraction). *Container*, 463 U.S. at 167-169. As part of this discussion, the Court quoted Mr. Justice Stevens' dissenting opinion in *Mobil* as follows (*Container*, 463 U.S. at 168, n. 5):

> Some States, it should be noted, have adopted a hybrid approach. In *Mobil* itself, for example, a nondomiciliary State invoked a unitary business justification to include an apportioned share of certain corporate dividends in the gross income of the taxpayer, but did not require a combined return and combined apportionment. The Court in *Mobil* held that the taxpayer's objection to this approach had not been properly raised in the state proceedings. 445 U.S., at 441, n. 15. JUSTICE STEVENS, however, reached the merits, stating in part: "Either Mobil's worldwide 'petroleum enterprise' is all part of one unitary business, or it is not; if it is, Vermont must evaluate the entire enterprise in a consistent manner." *Id.*, at 461 (citation omitted). See *id.*, at 462 (STEVENS, J., dis-

senting) (outlining alternative approaches available to State).

This issue was briefed by the taxpayers in *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F. W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), but the issue was not reached because this Court determined that the activities of the payor foreign subsidiaries were not part of the taxpayers' unitary businesses and, therefore, the payments in issue could not be included in apportionable income.

This case squarely presents the issue.

B. This Question Affects Taxpayers in Nearly Every State and Many Local Jurisdictions and Involves Billions of Dollars of Foreign-Source Earnings.

Forty-Four of the forty-five States that impose an income tax or a tax based on income apportion dividends, interest, or royalties received from unitary subsidiaries. App. D, 48a-56a. Many local jurisdictions also apportion dividends, interest, and royalties. *See, e.g.*, N.Y. City Admin. Code, §11-602(8).

The potential amount of foreign-source dividends, interest, and royalties subject to such taxation is enormous.[7]

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[7] In 1980 alone, approximately 11 billion dollars of dividends were paid by controlled foreign corporations (more than 50 percent owned by U.S. shareholders, *see* 26 U.S.C. § 957(a)) to U.S. corporations. Internal Revenue Service, Statistics of Income Division, Compendium of Studies of International Income and Taxes, Pub. 1267 (9-85), 194. According to the United States Department of Commerce, in 1987 approximately 27.73 billion dollars of dividends, interest, and royalties were paid by foreign affiliates to domestic parents, as defined in the International

The common practice of apportioning such foreign-source earnings without a correlative adjustment to the apportionment formula to reflect the property, payroll, and sales of unitary foreign subsidiaries has resulted in widespread disputes with tax authorities. Petitioner alone is contesting this issue in various audit, administrative, and judicial proceedings in forty-four States. Thousands of other U.S. corporations also receive payments from foreign subsidiaries,[8] and common sense dictates (in view of the number of taxpayers and the amount of repatriated earnings involved) that there are many other state disputes concerning this issue. In view of the number of taxpayers that are subject to apportionment formulas, the number of States that apportion foreign-source earnings, and the substantial amount of earnings involved, this issue is one of the most important, unresolved issues in state taxation. *See, e.g.*, Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon and H.R. 5076*, 79 Mich. L. Rev. 113, 121, 130 (1980). Its administrative importance cannot be overstated.

Investment Trade in Service Act, 22 U.S.C. §3102(3), (7) and (8). U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business, Vol. 68, number 6, 55 (June 1988) and Vol. 69, number 3, 46 (March 1989). Although the amounts reflected in both the Internal Revenue Service and U.S. Department of Commerce studies are not precisely the same as payments by unitary foreign subsidiaries, they confirm that such amounts are very substantial.

[8] The Internal Revenue Service reports that in 1980, 4,799 U.S. corporations filed information returns in connection with their holdings in controlled foreign corporations. Internal Revenue Service, Statistics of Income Division, Compendium of Studies of International Income and Taxes, *supra* at 181.

C. State Court Treatment of This Question Has Not Been Uniform.

This issue has not been dealt with uniformly by state courts. The Minnesota Supreme Court in this case concluded that Minnesota was not required by either the Due Process Clause or the Commerce Clause of the United States Constitution to adjust the Minnesota apportionment formula to include any portion of the property, payroll, and sales of Petitioner's unitary foreign subsidiaries. App. A, 23a-32a. The Court of Appeals of Maryland, in a case also involving Petitioner, concluded, with respect to dividends, that the Maryland apportionment formula "must be modified to reflect the foreign subsidiary factors" if the exclusion of "the portions of the foreign subsidiaries' property, payroll, and sales that generated the foreign subsidiary dividend income" results in distortion that "is of constitutional dimensions." *NCR Corp. v. Comptroller*, 313 Md. 118, 544 A.2d 764, 781-782 (1988).[9]

By comparison, in *Amer. Tel. & Tel. v. Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629, 636 (1988), the Wisconsin Court of Appeals concluded that the inclusion of dividends and interest received by AT&T from its unitary domestic subsidiaries in AT&T's apportionable income without adjusting the apportionment formula is constitutionally impermissible because the "apportionment formula used by the department does not reflect a reasonable sense of how A.T. & T.'s income is generated and taxes value earned outside the borders of Wisconsin, contrary to . . . the

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[9] The case was remanded to determine the amount of distortion and whether it was of constitutional dimensions. *NCR Corp. v. Comptroller*, 544 A.2d at 781.

due process and commerce clauses of the United States Constitution."[10]

It is important for this Court to address the issue left unresolved in *Mobil*, in order to avoid widespread state administrative and judicial proceedings and to insure that this issue is dealt with uniformly by all the States. *Cf. Fuller v. Oregon*, 417 U.S. 40, 42, n. 3 (1974).

II. THE DUE PROCESS AND COMMERCE CLAUSES WILL BE VIOLATED IF DIVIDENDS, INTEREST, AND ROYALTIES RECEIVED BY PETITIONER FROM ITS UNITARY FOREIGN SUBSIDIARIES ARE INCLUDED IN APPORTIONABLE INCOME WITHOUT A CORRELATIVE ADJUSTMENT OF THE MINNESOTA APPORTIONMENT FORMULA TO REFLECT THE PROPERTY, PAYROLL, AND SALES OF THE PAYOR FOREIGN SUBSIDIARIES.

The starting point under the Due Process and Commerce Clauses is the well-established principle that a State may tax a corporation only on that portion of its income that is attributable to its activities in the taxing State. The State may not tax "extraterritorial values" (*Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942)), or "tax value earned outside its borders" (*ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. at 315). In this case, Petitioner's activities in Minnesota comprise a small portion of Petitioner's worldwide unitary business. The issue, therefore, is to determine that portion of Petitioner's income that is fairly attributable to its Minnesota activities. The

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[10] On April 18, 1989, the parties to the AT&T case filed a Stipulation and Order with the Wisconsin Tax Appeals Commission reflecting an agreed disposition of the case.

Commissioner may not constitutionally tax income that is attributable to a non-Minnesota activity.

In judging whether a State's apportionment formula appropriately measures the portion of a taxpayer's apportionable income attributable to the taxpayer's in-state activities, this Court set forth the applicable test in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. at 169-170, as follows:

> [A]n apportionment formula must, under both the Due Process and Commerce Clauses, be fair. [Citations omitted.] The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State . . . ." [Citations omitted.] Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' [citation omitted] or has 'led to a grossly dis-

> torted result.' " [Citation omitted.] (Emphasis added by Court.)

The Minnesota apportionment formula fails the fair apportionment test of *Container*.

A. It Can Be Demonstrated with Mathematical Certainty that the Minnesota Apportionment Formula Subjects More Than All of Petitioner's Income to Tax, Thereby Violating the Internal Consistency Requirement.

The Minnesota Supreme Court concluded (App. A, 25a-26a) that Petitioner "has not demonstrated that exclusion of the subsidiaries' income producing activities in the denominator of Minnesota's formula would result in more than all of its income being taxed." This conclusion is simply wrong. It can be demonstrated with mathematical certainty that, if applied in every jurisdiction in which Petitioner does business, the Minnesota apportionment formula would unquestionably result in more than all of Petitioner's income being taxed.

Under the Minnesota apportionment formula, the denominator of the apportionment fraction included only Petitioner's separate property, payroll, and sales in those jurisdictions in which Petitioner conducted its separate corporate activities (the "NCR Jurisdictions"). The denominator did not include any of the property, payroll, or sales of Petitioner's unitary foreign subsidiaries in the foreign jurisdictions in which the subsidiaries conducted their separate corporate activities (the "Foreign Jurisdictions").

If the Minnesota apportionment formula were utilized by every NCR Jurisdiction, the entire apportionable income, including the foreign-source dividends, interest, and royalties, would be taxed by

those Jurisdictions. This is unquestionably so, since the property, payroll, and sales located in the NCR Jurisdictions, when taken together, equal 100 percent of the denominator of Petitioner's apportionment fraction. In addition, Petitioner is fully subject to tax by the Foreign Jurisdictions on the same foreign-source dividends, interest, and royalties included in apportionable income even though none of Petitioner's separate property, payroll, or sales are located in those Foreign Jurisdictions.[11] For example, as the Minnesota Supreme Court acknowledged (App. A, 25a), Petitioner paid taxes to Canada on Canadian-source dividends, interest, and royalties. If all the NCR Jurisdictions used the Minnesota apportionment formula, that same income would be taxed again.

If, however, as Petitioner requested, correlative portions of the foreign subsidiaries' property, payroll, and sales were included in the denominator of Petitioner's apportionment fraction, such international multiple taxation would not be inevitable. If the apportionment fraction were modified, less than 100 percent of the apportionable income would be taxed in the NCR Jurisdictions, thereby accommodating the fact that the foreign-source dividends, interest, and royalties included in apportionable income already were subject to full taxation, as income of Petitioner, by the Foreign Jurisdictions.

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[11] As explained on page 3 and n. 2, *supra*, Petitioner paid approximately $41.5 million of foreign withholding taxes during the years in issue. These foreign taxes are completely unrelated to the foreign income taxes paid by Petitioner's unitary foreign subsidiaries themselves on their own operating income.

B. The External Consistency Requirement Is Violated Because the Minnesota Formula Does Not Reflect a Reasonable Sense of How Income Is Generated.

As noted above, Mr. Justice Stevens concluded in his dissenting opinion in *Mobil* that Vermont had failed to apportion fairly Mobil's dividend income from its foreign subsidiaries because the State had not taken into account the property, payroll, and sales of the foreign subsidiaries that generated that income. He recognized the conceptual inconsistency between (i) including the foreign-source dividends in apportionable income on the grounds that (445 U.S. at 459) "the dividends represent the income of what would be operating divisions of the Mobil Oil Corporation if Mobil and its affiliates were a single, legally integrated enterprise,"[12] and (ii) then ignoring the property, payroll, and sales of the subsidiaries, which also would have been taken into account if the subsidiaries' activities were conducted in operating divisions of Mobil.

A taxing State may properly tax a corporation only on that portion of its income that is fairly attributable

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[12] The majority opinion in *Mobil* stated (445 U.S. at 440-441):

> Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements for apportionability. Cf. *General Motors Corp. v. Washington*, 377 U.S. 436, 441 (1964). Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives.

to the corporation's activities in that State. Petitioner agrees that, in determining this amount, it should make no difference whether the corporation's unitary business is conducted entirely through operating divisions of a single corporation or partly through separately incorporated subsidiaries. The results of operating a taxpayer's unitary business through a subsidiary will not be the same, however, as the results of operating through a division, unless the taxpayer's apportionment fraction is appropriately adjusted when dividends, interest, and royalties paid by the subsidiary are included in apportionable income.

Petitioner's Minnesota taxable income will unquestionably change under the Minnesota apportionment formula merely by transforming Petitioner's divisions into separate, legal entities. During the years in dispute, Petitioner conducted business in a number of countries directly through foreign branches. App. A, 15a. In 1980, for example, Petitioner's federal taxable income, and therefore Petitioner's Minnesota apportionable income, included $19,333,639 of foreign branch income. 1980 Minnesota Return. The property, payroll, and sales of those foreign branches also were taken into account in computing Petitioner's Minnesota taxable income. Under the Minnesota apportionment formula, if those foreign branches were incorporated and the foreign subsidiaries paid dividends, interest, and royalties, those amounts would be included in Petitioner's apportionable income, but no portion of the subsidiaries' property, payroll, or sales would be taken into account. Thus, Petitioner's Minnesota taxable income would unquestionably change merely by changing its form of doing business

in the foreign jurisdictions. This result cannot be correct.

Purporting to rely on this Court's approach in *Container*, the Minnesota Supreme Court concluded (App. A, 32a) that the amount of distortion caused by the Minnesota apportionment formula (asserted by the Commissioner to be 23 percent for the years at issue) was constitutionally acceptable. This also is incorrect. In the first place, as discussed above (p. 10, n.6), Petitioner has demonstrated that the percentage of distortion is much more serious than was assumed by the court. In view of the huge amounts of dividends, interest, and royalties involved, the significant increase in Petitioner's apportionable income is obvious.

More fundamentally, however, the court's reliance on the amount of distortion misses the point. Where, as in *Container*, the taxpayer complains about the distortion caused by a conceptually sound apportionment formula (*i.e.*, where there is an appropriate conceptual relationship between the apportionable income base and the apportionment fraction), it is understandable that the taxpayer must demonstrate gross distortion. Unlike the situation in *Container*, however, the Minnesota apportionment formula is *not* conceptually sound. This is not a situation where the apportionment formula " '*may* result in taxation of some income that did not have its source in the taxing State . . . .' " *Container*, 463 U.S. at 169-170, quoting from *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272 (1978) (emphasis added in *Container*). The Minnesota apportionment formula *inevitably* results in the *systematic* taxation of a portion of Petitioner's foreign-source income earned by activities conducted entirely outside the State. Such a quaranteed, annual increase

in Petitioner's taxable income (even if it were 23 percent every year) cannot be justified by this Court's discussion of the apportionment formula at issue in *Container*. *See* 463 U.S. at 183-184. As this court pointed out in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), an "inherently arbitrary" apportionment formula is invalid, and the amount of distortion it causes is constitutionally immaterial.

Such taxation of "extraterritorial values" in this case (*Butler Bros. v. McColgan*, 315 U.S. at 507) is far different from taking foreign-source income into account (as part of an overall apportionment procedure for determining the corporation's income from its activities within the taxing State) where the income producing activities that generated the foreign-source income also are reflected in the apportionment fraction. *See, Shell Oil Co. v. Iowa Dept. of Revenue*, 488 U.S. ___ , 109 S.Ct. 278, 284 (1988).

III. THE MINNESOTA APPORTIONMENT FORMULA ALSO VIOLATES THE COMMERCE CLAUSE BY CAUSING INTERNATIONAL MULTIPLE TAXATION OF FOREIGN COMMERCE AND PREVENTING THE UNITED STATES FROM SPEAKING WITH ONE VOICE.

The Commerce Clause restrictions on state taxation of foreign commerce were extensively reviewed by this Court in *Container* and *Japan Line*. Where only interstate commerce is involved, a state tax will be upheld if it is applied to an activity having a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State. *Complete Auto Transit, Inc. v.*

Brady, 430 U.S. 274, 279 (1977); *Washington Rev. Dept. v. Stevedoring Assn.*, 435 U.S. 734, 750 (1978). But, as this Court held in *Japan Line*, when a State seeks to tax foreign commerce, two additional questions must be considered (441 U.S. at 451) —

> first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments." If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause.

In *Japan Line*, the question was whether local government units in California could impose fairly apportioned property taxes on Japanese owned cargo containers that were, under the custom of nations, subject to an unapportioned property tax in Japan. Because the full value of the containers was taxed in Japan, this Court held that *any* additional state or local tax, regardless of how the tax was apportioned, would inevitably produce international multiple taxation in contravention of the Commerce Clause.

As in *Japan Line*, the Commissioner's inclusion of Petitioner's foreign-source dividends, interest, and royalties in apportionable income, without any reflection of the property, payroll, and sales of the payor foreign subsidiaries, in the apportionment formula, inevitably "creates more than the *risk* of multiple taxation; it produces multiple taxation in fact." *Japan Line*, 441 U.S. at 452. This can easily be demonstrated. First, there is worldwide recognition of the

principle that the source nation (*i.e.*, the nation where income originates) has the primary right to tax, on an unapportioned basis, the full, gross amount of dividends, interest and royalties, and other similar items of income paid by a resident of the source nation to a nonresident.[13] Thus, in accordance with that "cus-

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[13] Virtually every developed noncommunist country in the world has an income tax structure that is designed to avoid double taxation of international income by effectively giving taxing priority to the source nation. This is generally done either by excluding the foreign-source income from the tax base altogether, or by taxing it and then allowing a credit for the tax imposed by the source nation. *See* Dr. D. Juch, "General Report on Unilateral Measures to Prevent Double Taxation," *Cahiers de Droit Fiscal International*, Vol. LXVI b, International Fiscal Association, XXXV Congress, Berlin (1981).

Since the enactment of Sections 222 and 238 of the Revenue Act of 1918, 40 Stat. 1057, the revenue laws of the United States also have been premised on the principle that the jurisdiction where income is generated has the primary right to tax that income with the result that United States taxpayers have been allowed to reduce their regular federal tax liability by the amount of foreign income tax paid on their foreign-source income. Surrey, *Current Issues in the Taxation of Corporate Foreign Investment*, 56 Colum. L. Rev. 815, 817 (1956); E. Owens, *The Foreign Tax Credit* (1961), pp. 2-3, 590-591; S. Rep. No. 99-313, 99th Cong., 2d Sess., 293 (1986). The United States has also reduced the risk of double taxation of dividends, interest, and royalties through tax treaties which assure that the recipient's country will allow a credit or offset for taxes paid to the source country. *See* U.S. Model Income Tax Treaty, Art. 23 (1977). The model international tax conventions have recognized the primary right of the source nation to impose a tax, with the nation where the recipient resides having a concomitant responsibility to reduce its regular tax on that income by an equivalent amount. *See* Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Cap-

tom of nations" (*Japan Line*, 441 U.S. at 447, 454), most of the countries in which Petitioner's unitary foreign subsidiaries operate tax Petitioner directly on the full amount of dividends, interest, and royalties that Minnesota also seeks to tax on an apportioned basis.[14] As an example, Canada imposed an income withholding tax on dividends, interest and royalties paid by Petitioner's Canadian subsidiary.[15] App. A, 25a. Thus, this case is on all fours with *Japan Line* where the local United States jurisdictions were not permitted to impose a property tax (even on an apportioned basis) since the property already was fully subject to tax in the foreign country.

In rejecting the taxpayer's argument in *Container*, this Court stated (463 U.S. at 192-193) that "[i]f California's method of formula apportionment 'inevitably' led to double taxation . . . that might be reason enough to render it suspect." As demonstrated above,

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ital, Articles 10, 11 and 23 (1977). Consistent with this custom of nations, the United States generally imposes a tax on dividends, interest, and royalties paid by U.S. residents to nonresidents. 26 U.S.C. 871-872, 1441-1442.

[14] See n. 2 and n. 11, *supra*.

[15] *See* Secs. 212(1)(b), 212(1)(d), and 212(2) of the Income Tax Act [of Canada]. Under these laws, as limited by Article XI (1) of the Income Tax Treaty between Canada and the United States (1941), during the years in issue, dividends, interest, and royalty payments were generally subject to a 15 percent withholding rate. Although the tax is remitted to the Canadian government by the foreign payor, the payor is simply acting as a withholding agent for the recipient. The amount of withholding taxes paid by Petitioner on the dividends, interest, and royalties included in apportionable income was reported on Petitioner's federal tax return and made part of its 1977-1981 Minnesota Returns. See n. 2, *supra*.

the Minnesota apportionment formula inevitably leads to double taxation.

The United States can speak with "one voice" in regulating foreign commerce only if the States and local jurisdictions that choose to tax income from foreign commerce are required to recognize and implement the basic policies that the Federal Government applies in taxing such income. The avoidance of double taxation of foreign-source income is such a policy. Moreover, the Federal Government's policy in this area is clearly in accord with the "custom of nations." See *Japan Line*, 441 U.S. at 447, 454. Because this policy is firmly embedded in federal law and treaties, and clearly constitutes the custom of nations, it is constitutionally intolerable for the States to disregard it.

Multiple taxation in fact will be eliminated here if the dividends, interest, and royalties are excluded from apportionable income under the reasoning of *Japan Line*. At a minimum, the Commerce Clause compels Minnesota to adjust its apportionment formula to reflect the property, payroll, and sales of Petitioner's unitary foreign subsidiaries.

CONCLUSION

The petition for a writ of certiorari to review the judgment of the Minnesota Supreme Court should be granted.

Respectfully submitted,

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APPENDIX

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APPENDIX A

STATE OF MINNESOTA
TAX COURT - REGULAR DIVISION
DOCKET NO. 4224

NCR Corporation,

Appellant,

vs.

Commissioner of Revenue,

Appellee.

FINDINGS OF FACT,
CONCLUSIONS OF LAW AND
ORDER FOR JUDGMENT

Dated: March 8, 1988

The above-entitled matter was submitted to the Court for decision through a Stipulation of Facts and briefs of the parties. Oral arguments were presented before the Honorable Earl B. Gustafson, Chief Judge of the Minnesota Tax Court, on January 8, 1988 at the Courtroom of the Tax Court in St. Paul, Minnesota.

James W. Littlefield, of Hart, Bruner, O'Brien & Thornton, P.A., appeared for appellant.

Thomas R. Muck, Deputy Attorney General, appeared for the appellee.

The Court, having heard and considered the arguments of counsel and upon all of the files and records herein, now makes the following:

FINDINGS OF FACT

1. Appellant, NCR Corporation (hereinafter "NCR"), appeals from an assessment of additional corporate franchise taxes for the tax years 1977 through 1981 contained in an assessment bearing a notice date of September 21, 1984.

2. On or about November 16, 1984, NCR paid to the appellee the amount of $319,640.93 and on November 20, 1984 filed the above-captioned appeal.

3. NCR is incorporated under the laws of the State of Maryland and has its corporate offices and principal place of business at 1700 South Patterson Boulevard, Dayton, Ohio.

4. NCR transacts business partly within and partly without the State of Minnesota. It has done business in Minnesota in all tax years at issue and in each of those years maintained manufacturing and sales facilities in Minnesota.

5. NCR has a network of foreign subsidiaries which, with the parent NCR, form a unitary business. These foreign subsidiaries have not conducted any business within the State of Minnesota.

6. NCR obtains and utilizes patents as a part of its ordinary business and pursuant to patent licensing agreements, grants to its foreign subsidiaries the right to manufacture and sell business machines and equipment patented by NCR.

7. For the years 1977 through 1981, NCR received dividends, interest and royalties from its foreign subsidiaries as follows:

Year	Dividends	Interest	Royalties
1977	$41,983,566	$ 3,197,520	$21,656,173
1978	41,931,362	5,852,927	19,466,545
1979	51,576,630	9,027,754	16,830,324
1980	61,583,067	15,325,626	28,462,939
1981	34,416,542	20,769,392	40,153,073

8. NCR represents that for the years 1977 through 1981 those foreign subsidiaries from whom NCR received the aforementioned royalties had total net sales, payroll and properties as follows:

Year	Net Sales	Payroll	Properties
1977	$ 784,563,576	$245,614,128	$ 572,151,937
1978	733,390,600	235,891,484	585,423,054
1979	920,776,019	305,273,740	679,024,091
1980	1,336,081,709	439,517,670	904,220,615
1981	1,280,299,312	424,380,977	1,039,846,133

These figures have not been audited or otherwise verified by appellee. However, the parties have agreed that NCR may use them for illustrative purposes only in this appeal and that, should the Court enter some order requiring a recomputation of tax which would depend on these figures, they would be first audited by appellee.

9. For the years 1977 through 1981, for purposes of determining Minnesota taxable income, NCR's apportionable income was as follows:

Year	Apportionable Income
1977	$131,514,040
1978	278,240,145
1979	299,499,453
1980	186,791,768
1981	168,347,373

10. The 1978 and 1979 apportionable income figures include $25,070,121 and $66,568,278, respectively, which income resulted from NCR's sale of the assets of one of its divisions, Appleton Paper Company.

11. NCR asserts that because the proportion of its apportionable income received from its foreign subsidiaries is so great, the net sales, property and payroll of its foreign subsidiaries must be included in calculating the sales, payroll and property factors of Minnesota's three-factor apportionment formula.

12. NCR further asserts that that portion of Minn. Stat. § 290.21, subd. 4 (1980) is unconstitutional which allows a

tax exemption of 15% of the dividends paid by a subsidiary corporation to a parent corporation that owns 80% or more of its stock if the "dividends were paid from income arising out of business done in this state by the corporation paying such dividends."

CONCLUSIONS OF LAW

1. The Commissioner correctly did not include the net sales, payroll and property of NCR's foreign subsidiaries in calculating the sales, payroll and property factors that were applied to NCR's apportionable income.

2. The Order of the Commissioner of Revenue dated September 21, 1984, relating to the corporate income tax liability of appellant for the years 1977, 1978, 1979, 1980 and 1981, is affirmed.

LET JUDGMENT BE ENTERED ACCORDINGLY. A STAY OF 15 DAYS IS HEREBY ORDERED.

BY THE COURT,

/s/ Earl B. Gustafson
Earl B. Gustafson, Chief Judge
Minnesota Tax Court

DATED: March 8, 1988

MEMORANDUM

Minnesota taxes the income of corporations that do business both within the state and outside the state. To be constitutional such income must be fairly apportioned. *Northwestern States Portland Cement Company v. Minnesota*, 358 U.S. 450, 79 S.Ct. 357 (1959). The taxable income allocable to Minnesota is determined under a statute that details a three-factor apportionment formula. Minn. Stat. § 290.19(2)(a) (1980). The three factors are the corporation's total sales, property and payroll. The in-state total for each factor is then compared with the company-wide total, and then each factor is expressed as a fraction. The numerator of the sales factor, for example, is the amount of a company's in-state sales; the denominator is the total of all of the company's sales. The payroll and property factors are computed in the same fashion. The three factors are then averaged, resulting in a percentage figure that can be applied to the company's total business income to determine the amount of income allocated to this state for tax purposes.

Minnesota apportioned income during the tax years at issue by a single entity apportionment formula,[1] by which a taxpayer corporation's property/payroll/sales in Minnesota is compared to the taxpayer's total property/payroll/sales (Minnesota and elsewhere), without reference to the factors of any subsidiary corporations. Minn. Stat. § 290.19,

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[1] For tax year 1982 and subsequent years the Legislature changed to a multi-entity "combined reporting" apportionment calculation under which the numerator of the apportionment ratios consists of the property/payroll/sales of the filing taxpayer in Minnesota and the denominator consists of the property/payroll/sales of all domestic corporations which, with the filing taxpayer, conduct one unitary business. This percentage is then applied against the total income of all corporations which together conduct a unitary business, rather than against just the income of the filing taxpayer as under the pre-1982 separate entity method. *See* Minn. Stat. 290.17, subd. 4 (f) and (g) (1987 Supp.) for the current combined reporting statutes.

subd. 1(a) (1980). Each corporate taxpayer then, as now, filed a separate return. Minn. Stat. § 290.37, subd. 1 (1980), provides:

> "[E]very corporation shall file a return with respect to its taxable net income . . . ."

It is thus the taxable net income of each filing corporation, such as NCR, which, after deductions, is apportioned under the three-factor formula. *See* Minn. Stat. § 290.19, subd. 1 (1980).

There are two issues that must be discussed: (1) Should the sales, payroll and property factors of foreign subsidiaries be included in Minnesota's three factor apportionment formula if they pay dividends and royalties to appellant? And, (2) Does the Minnesota Tax Court have authority to determine the constitutionality of Minn. Stat. § 290.21, subd. 4 (1980)?

ISSUE NO. 1: SHOULD THE SALES, PAYROLL AND PROPERTY FACTORS OF FOREIGN SUBSIDIARIES BE INCLUDED IN THE APPORTIONMENT FORMULA IF THEY PAY DIVIDENDS/ROYALTIES TO APPELLANT?

Appellant NCR received dividends, interest and royalties from foreign subsidiaries that both parties agree should be considered to be business income received by NCR. A portion of this gross income, after deduction of expenses, became net income, a portion of which, in turn, was apportioned to Minnesota under the three-factor formula and taxed at the regular corporate income tax rate.

The issues of this case focus on this income received by NCR from its foreign subsidiaries who conducted no business in Minnesota. NCR argues that inclusion of the dividend income and royalty income in Minnesota's apportioned income requires the inclusion of the entire payroll, property and sales of these foreign subsidiary corporations in the apportionment formula.

We disagree and are affirming the Commissioner's method of calculation which does not consider the sales, property and payroll of foreign subsidiaries that contribute income to NCR.

NCR presents a commerce clause/due process argument in attacking Minnesota's apportionment formula. The burden on a taxpayer who would have the Court find an apportionment formula unconstitutional is substantial. As restated by the U. S. Supreme Court in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933 (1983):

> *Under both the Due Process and the Commerce Clauses of the Constitution, a state may not, when imposing an income-based tax, "tax value earned outside its borders."* . . . [T]he *taxpayer has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed. . . ."*

463 U.S. at 164, 103 S.Ct. at 2939-40 (emphasis added, citations and footnote omitted).

NCR has, in our opinion, failed in its burden to demonstrate that the apportionment formula is in any way constitutionally defective.

A judicial philosophy of restraint in examining an apportionment formula under the commerce and due process clauses was described in the *Container* opinion where the court said:

> In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" [in order that a state may avoid taxing value earned outside its borders] is often an elusive goal, both in theory and in practice . . . . For this reason and others, we have long held that

> the Constitution imposes no single formula on the states, ...

463 U.S. at 164, 103 S.Ct. at 2939 (citations and footnotes omitted). There is thus no one type of formula which is constitutionally mandated. Three-factor (property/payroll/sales) apportionment formulas such as Minnesota's have, however, gained wide acceptance as a means of separating one state's income from another, thus avoiding extraterritorial taxation.

The well known standards by which, under the Commerce and Due Process clauses, apportionment formulas are tested were recently restated by the Minnesota Supreme Court in *Westinghouse Electric Corporation v. Commissioner of Revenue*, 398 N.W.2d 530, 537-38 (Minn. 1986), where it quoted from the *Container* opinion. The principal test is that the apportionment formula meet the standards of internal and external consistency:

> [A]n *apportionment formula must*, under both the Due Process and Commerce clauses, be *fair* . . . . *The first*, and again obvious, *component of fairness* in an apportionment formula is what might be called *internal consistency—that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed.* The *second* and more difficult requirement is what might be called *external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.* The Constitution does not "invalidat[e] an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing state . . . .

463 U.S. at 169-70, 103 U.S. at 2942 (emphasis added, citations and footnotes omitted).

In *Westinghouse Electric Corporation v. Commissioner of Revenue, supra,* our Supreme Court held that Minnesota's apportionment formula was both internally and externally consistent.

NCR's argument is based upon the misperception that Minnesota is somehow taxing the income of corporations paying dividends or royalties to NCR or that it is taxing the income of its multicorporation unitary business.

Minnesota is not, however, taxing the unitary income of NCR. It is taxing neither the entire income of NCR's worldwide unitary business nor that of the particular subsidiaries which paid NCR dividends and royalties. Minnesota is taxing only actual intangible income (dividends and royalties) received by a single taxpayer (NCR) doing business in Minnesota. The "net income" apportioned by the apportionment formula is that of the individual filing taxpayer only, in this case, NCR. *See* Minn. Stat. § 290.19, subd. 1 (1980). The factors (property/payroll/sales) are therefore properly the factors of NCR alone. Minnesota does not include in NCR's net income the income of any other corporation, whether affiliated with NCR or not.

Due process/commerce clause principles operate only as a limitation upon the outer reach of this statutory inclusion of intangible income. To avoid extraterritorial taxation there must be a sufficient connection between the intangible income received by the taxpayer and the business conducted within the state. The rationale is that the income is from property employed by taxpayer in its business within and without the state. The paying corporation does not have to be related to the taxpayer at all. For the income to be apportioned it merely has to be shown that it came from property employed in a business that is conducted both within Minnesota and other states.

Who pays the intangible income to the taxpayer is irrelevant. If the dividend or royalty income came from an unrelated corporation it would be included in the income

that is apportioned but the entire payroll, property and sales of this unrelated corporation would not be considered. There is no inconsistency in including in apportionable income the dividends and royalties NCR received from subsidiary corporations while not modifying the apportionment formula to include the payroll, property and sales factors of these corporations.

The Maryland Court of Special Appeals, in *Comptroller of the Treasury v. NCR Corporation*, 71 Md.App. 116, 524 A.2d 93, *cert. granted* 310 Md. 275 (1987), recently held against NCR in a similar case.

In the Maryland case, as in this case, NCR asserted that the property, payroll and sales of subsidiaries from whom it received dividend and royalty income must be included in its factors. 524 A.2d at 105. The Court held that neither the Maryland statute nor the Constitution required this modification to the apportionment formula. The Court rejected NCR's arguments pointing out that NCR confused taxation of the dividends and royalty income to NCR itself with taxation of the income from which the dividends were paid to NCR. The Court observed:

> Notwithstanding the fact that the income of NCR's foreign subsidiaries is not taxable in Maryland, NCR argues for inclusion of NCR's worldwide values of property, payroll and sales on the ground that Maryland taxes NCR's royalty and dividend income from the foreign subsidiaries. This income, however, is irrelevant to the matter at hand. *The royalty and dividend income is taxable, not as income of the foreign subsidiaries, but as income of the domestic parent earned in the ordinary course of its unitary business, the production and sale of office machines. Since NCR's taxable income does not reflect the actual income earned by any of its foreign subsidiaries, we think that the apportionable formula should*

> *mirror this approach. Accordingly, we hold that the worldwide values of sales, property and payroll should be excluded from the apportionment factor. To incorporate this value, as NCR suggests, would produce a gross distortion in the apportionment formula, which unduly favors taxpayers such as NCR.*

524 A.2d at 105-06 (emphasis added).

Adopting NCR's argument would, as the Maryland court said, grossly distort the apportionment formula. The modification which it seeks would dramatically lower the percentage of its income taxed by Minnesota. The numerators of the property/payroll/sales factors in the formula remain the same while the denominators expand significantly. This is so because the foreign subsidiaries have no Minnesota payroll, property or sales. The denominators, however, are substantially expanded by inclusion of the payroll, property and sales of the foreign subsidiaries since all of the property, payroll and sales of those corporations are outside Minnesota. With a constant numerator and a significantly larger denominator the apportionment percentage and hence the percentage of NCR's income taxed by Minnesota is understated.

NCR admittedly receives substantial dividend and royalty income from its foreign subsidiaries. This ranged from 22% to 48% of its apportionable income during this period. (NCR does not argue that interest income should trigger inclusion of the subsidiaries' factors in the apportionment formula.) Similarly situated taxpayers, of course, have to be treated equally. Therefore, a corporation that received only minuscule dividends from a foreign subsidiary would be entitled to the same type of apportionment formula that NCR advocates.

We find no unconstitutional violation of either the due process or commerce clauses in the method of apportion-

ment used by the Commissioner in assessing appellant's taxes.

ISSUE NO. 2: DOES THE MINNESOTA TAX COURT HAVE AUTHORITY TO DETERMINE THE CONSTITUTIONALITY OF MINN. STAT. § 290.21, SUBD. 4 (1980)?

We have been talking about dividends, royalties and business income received by NCR from its foreign subsidiaries. All are included in NCR's total income, a small percentage of which Minnesota taxes after it is apportioned under the three-factor formula. To understand the next issue we must focus on dividends only—dividends received by a corporation like NCR that does business both within and without Minnesota.

For the years in question, Minn. Stat. § 290.21, subd. 4 (1980) allowed a corporation to exclude from apportionable income 100 percent of all dividends received from subsidiaries doing business solely within Minnesota. This means that dividends derived from Minnesota activities are not taxed. If the subsidiary did business outside of Minnesota, only 85 percent of the dividends received were excludable so that 15 percent are subject to taxation. This appears to discriminate against interstate commerce and is probably unconstitutional under the Commerce Clause of the Federal Constitution. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076 (1977); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 104 S.Ct. 1856 (1984); *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049 (1984).

All of the dividends NCR receives come from corporations that do business entirely outside Minnesota so 85 percent of these dividends are excluded, not 100 percent excluded as would be the case if the dividends came only from Minnesota business. NCR urges the Court to find the statute unconstitutional and treat the taxation of all dividends received equally by excluding them 100 percent. The appropriate remedy, however, might be to eliminate

the 100 percent exclusion accorded to dividends from only Minnesota business activities and treat all dividends received equally by excluding 85 percent in every case. See *Johnson Brothers Wholesale Liquor Co. v. Commissioner of Revenue*, 402 N.W.2d 791 (Minn. 1987).

The threshold question, however, is whether the tax court has jurisdiction to pass on this constitutional issue. Under *Matter of McCannel*, 301 N.W.2d 910, 920 (Minn. 1980), we clearly do not have the authority to declare a statute unconstitutional unless the case is transferred to tax court from district court. This case was filed in tax court and came to us directly, not by a transfer from district court. Therefore we have no authority to make a ruling on the constitutionality of Minn. Stat. § 290.21, subd. 4 (1980) and decline to do so.

E.B.G.
Dated this 8th day of March, 1988
_____, Deputy
Docket 4224

STATE OF MINNESOTA
IN SUPREME COURT
C2-88-762

Tax Court

NCR Corporation,

Relator,

vs.

Commissioner of Revenue,

Respondent.

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Kelley, J.
Took no part:
Keith, J.

Filed February 24, 1989
Office of Appellate Courts

SYLLABUS

1. Minnesota's corporate income apportionment statute (Minn. Stat. § 290.19 (1980)), based on a separate entity reporting concept, does not require inclusion of factors of property used, sales made, and payroll paid of foreign solely owned subsidiaries of a corporate taxpayer in the apportionment formula.

2. Although a nonresident corporate taxpayer, which must file a corporate income tax return in this state, is required to include as income in the denominator of an apportionment statutory formula dividends, interest, and royalties received by it from subsidiaries and licensees, exclusion from the denominator of the formula property owned, sales made, and payroll paid factors of the subsidiaries does not offend the Due Process Clause of the United States Constitution.

3. Excluding foreign subsidiaries' factors of property used, sales made, and payroll paid does not result in violation of the Commerce Clause of the United States Constitution.

Affirmed.

Heard, considered and decided by the court en banc.

OPINION

KELLEY, Justice.

Relator, NCR Corporation, (NCR) appeals from an order of the Tax Court upholding the Respondent Commissioner of Revenue's (Commissioner) order which assessed additional corporate taxes against the relator for the years 1977-1981, and dismissed the relator's constitutional challenges to the statute under which the tax was assessed, Minn. Stat. § 290.19 (1980). We affirm the Tax Court's order which sustained the Commissioner's additional assessment, and find the apportionment formula constitutional.

Relator NCR Corporation is a Maryland corporation with its principal place of business in Dayton, Ohio. NCR conducts some of its business within the State of Minnesota. It likewise transacts business in other states, and, additionally transacts business in foreign countries through its foreign branches and subsidiaries. None of the foreign subsidiaries transact business in the State of Minnesota, nor do any pay taxes in the State of Minnesota. NCR, its branches and its subsidiaries form a "unitary business" within the meaning of Minnesota's corporate income tax laws.

Relator's business involves the manufacture and sale of business machines and equipment. By means of licensing agreements, it has granted the subsidiaries the right to manufacture and sell machines and equipment patented by it. In return, NCR receives royalty payments from the

foreign subsidiaries. NCR's gross income also includes dividend payments made to it by its foreign subsidiaries.[1]

Relator filed its corporate tax returns for the tax years in question with the State of Minnesota, as required by Minn. Stat. § 290.37, subd. 1 (1980). Only that portion of NCR's income attributable to its activities in Minnesota was taxable by Minnesota. In its returns for the tax years in question, NCR calculated that portion attributable to Minnesota pursuant to a formula found in Minn. Stat. § 290.19 (1980). That statute provides a method which uses a percentage of the taxpayer's gross income, less enumerated allowed deductions, to reach apportionable income. The gross income percentage is obtained by making three calculations: the sales made, property used, and payroll paid in Minnesota being the numerator, compared to the total sales made, property used and payroll paid elsewhere, the denominator. In its 1977-1981 Minnesota income tax returns, NCR had excluded income from royalties paid by licensees as well as dividends and interest it had received from its foreign subsidiaries. On audit, the Commissioner included that income in NCR's apportionable income. It is that inclusion that originally gave rise to this appeal.

Relator challenged the Commissioner's action of including the foreign income by appealing to the Tax Court. There, as here, it asserts that the inclusion of the foreign income (dividends and royalties) is not required by the statute, and that the Commissioner's inclusion of it was unconstitutional. Alternatively, it argues that if the foreign payments were to be included in its gross income, then the payroll paid, property used and sales made figures for the subsidiaries must likewise be included in the denomi-

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[1] The foreign subsidiaries also pay interest to NCR which, of course, is income to it. The Commissioner included this interest in the computation of NCR's income attributable to Minnesota for the tax years in question. NCR does not challenge its inclusion in its notice of appeal from the Commissioner's order.

nator of the fraction used in computing NCR's apportionable income.[2]

The Tax Court rejected both of NCR's contentions. It held the statutory scheme did require inclusion of subsidiary and licensee payments as part of NCR's gross income, but that no adjustment in the apportionment formula was required so as to take into account the subsidiaries' payroll paid, property used and sales made figures. Additionally, the Tax Court concluded the apportionment formula was not so disproportionate as to be unconstitutional under the Due Process and Commerce Clauses of the United States Constitution.

1. We first address relator's challenge to the apportionment formula as applied by the Commissioner. Our review of questions of fact is limited to ascertaining whether sufficient evidence exists to support the Tax Court's findings of fact, but we have plenary review of legal questions. *Nagaraja v. Comm'r of Revenue*, 352 N.W.2d 373, 376 (Minn. 1984).

In order to tax the income of corporations engaged in more than one state, the taxing state must determine what portion of the corporation's income is attributable to the corporation's business activities within its own jurisdiction. To do so, all states employ some type of mathematical formula to apportion the corporation's income. One approach, the "formula apportionate" method, takes the total income of the corporation, the tax base, and apportions it to the taxing jurisdiction through the use of up to three objective factors: the property used, payroll paid and sales

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[2] In the Tax Court, NCR also challenged the constitutionality of Minn. Stat. § 290.21, subd. 4 (1980). This statute allowed a corporation doing business *outside* of Minnesota to exclude 85 percent of dividends received, while an *in-state* corporation excludes 100 percent. The Tax Court refused to address this issue, finding it did not have jurisdiction. NCR has not challenged this ruling in its Writ of Certiorari to this Court, thus it is not addressed in this opinion.

made factors. These factors are thought to be objective measures of the corporation's activities within and without the taxing jurisdiction. *See Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 165 (1983). The property used, payroll paid and sales made activities of the corporation *within the state*, the numerator, are compared to the activities *outside the state*, the denominator, to arrive at a percentage of the tax base attributable to the corporation's activities within the taxing jurisdiction.

During the tax years at issue (1977-1981), Minnesota's formula taxed corporations on a separate entity basis—taxing each on its own income, which included income such as dividends paid by subsidiaries or royalties paid to it by licensees. This procedure entailed comparing the corporate taxpayer's total property used, payroll paid and sales made factors in Minnesota with the total of the same items elsewhere. Combined reporting, that is, reporting of a parent corporation's income with that of its subsidiaries, was generally not permitted, although the Commissioner had certain discretion to allow combined reporting only if the separate entity formula proved to be "unfair." *See Westinghouse Elec. Corp. v. Comm'r of Revenue*, 398 N.W.2d 530, 536-37 (Minn. 1986).[3]

In support of its argument that the apportionment statute required the inclusion of at least a part of its foreign subsidiaries' expenses in the denominator of the apportionment formula fraction, NCR relies on statutory language such as "total sales" and "wherever located" and "wherever made."[4]

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[3] In 1982, the Minnesota Legislature amended Minn. Stat. § 290.34 (1982) to permit affiliated corporations, such as a parent and subsidiary, to file a "combined report." *See* Minn. Stat. § 290.34, subd. 2 (1984). Under this method, a corporation and its affiliated companies would file one return, combining their income and apportionment factors.

[4] The statute it relies on is Minn. Stat. § 290.19, subd. 1(1)(1980) which reads as follows:

The Commissioner responds to that contention by pointing out that under the taxing statutes the state may not and does not tax the income of a corporation's foreign subsidiaries which do no business in the state. Therefore, their factors of property used, payroll paid and sales made should not be included in the denominator of the formula fraction. In order to determine which of these positions is correct, we are required to construe the apportionment

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Subdivision 1. Computation, business conducted partly within state; apportionment. The taxable net income from a trade or business carried on partly within and partly without this state shall be computed by deducting from the gross income of such business, wherever derived, deductions of the kind permitted by section 290.09, so far as connected with or allocable against the production or receipt of such income. The remaining net income shall be apportioned to Minnesota as follows:

(1) If the business consists of the mining, producing, smelting, refining, or any combination of these activities of copper and nickel ores, or of the manufacture of personal property and the sale of said property within and without the state, the remainder shall be apportioned to Minnesota on the basis of the percentage obtained by taking the arithmetical average of the following three percentages:

(a) The percentage which the sales made within this state is *of the total sales wherever made*;

(b) The percentage which the total tangible property, real, personal, and mixed, owned or rented, and used by the taxpayer in this state during the tax period in connection with such trade or business *is of the total tangible property*, real, personal, or mixed, *wherever located*, owned or rented and, used by the taxpayer in connection with such trade or business during the tax period; and

(c) The percentage which the taxpayer's total payrolls paid or incurred in this state or paid in respect to labor performed in this state in connection with such trade or business is of the taxpayer's *total* payrolls paid or incurred in connection with *such entire trade or business*; (emphasis supplied)

statute, keeping in mind that our task when construing a statute is to ascertain and give effect to the legislative intent. Minn. Stat. § 645.16 (1988). *See Mankato Citizens Tel. Co. v. Comm'r. of Taxation*, 275 Minn 107, 111, 145 N.W.2d 313, 317 (1966).

At the outset, we note that to construe the statute as NCR urges would be tantamount to our holding that when the legislature uses such terms as "gross income" in describing the tax base, and language such as "total" and "wherever located" in the apportionment statute, it intended that a corporation's foreign source income as well as its subsidiaries' activities both be included in the fraction when undertaking to apportion income. Such a result would be inconsistent with the nature of a single-entity apportionment formula.

NCR supports its position by relying on the Nebraska case *Kellogg Co. v. Herrington*, 343 N.W.2d 326 (Neb. 1984), one of the two appellate decisions which have come closest to addressing the specific question presented by this case. Nebraska's statute utilized a three-factor apportionment formula similar to Minn. Stat. § 290.19 (1980). Nebraska's statute identified the factors going into the formula as "all" the property used, payroll paid "everywhere," and the sales made "everywhere." Neb. Rev. Stat. § 77-2744. The Nebraska court, relying on its rules of statutory construction, held that the language employed clearly and without ambiguity included designated foreign subsidiaries' activities in the denominator of the apportionment formula fraction. *Id.* at 332. Thus, in effect, the Nebraska court concluded that its apportionment formula contemplated combined reporting by a corporate taxpayer and its affiliated companies.

On the other hand, the Commissioner finds support for his position in a decision of the Maryland Court of Appeals which reached a contrary result when construing similar statutory language in Maryland's statute. *NCR Corp. v.*

Comptroller, 544 A.2d 764 (Md. 1988). The Maryland court rejected Nebraska's analysis because "it was heedless of legislative intent and legislative history." *Id.*, at 777. Instead, the Maryland court emphasized that it was the state's goal to tax" * * * so much of a corporation's net income as is constitutionally permissible." *Id.* Because Nebraska's approach served the opposite result, to-wit: the lowest possible tax to the state, Maryland rejected the Nebraska analysis. Additionally, it noted that reference in the apportionment statute to "the taxpayer" definitionally excluded the taxpayer's subsidiaries. Accordingly, the Maryland court appeared unwilling to construe its statute so as to permit "combined reporting."

We find the Maryland approach more persuasive than Nebraska's. Minnesota, as did Maryland, in the tax years at issue, sought to tax a foreign corporation's income to the extent constitutionally possible. Minn. Stat. § 290.17, subd. 2(4) (1980) reflected a legislative objective to maximize Minnesota's collection of income taxes from corporations doing business in Minnesota by adopting the "unitary business" concept as well as enacting the three-factor single-entity apportionment formula in Minn. Stat. § 290.19, subd. 1(2)(a)(1980). The thread of this policy, though perhaps never precisely articulated, likewise runs through our cases rejecting corporate taxpayer challenges to that system, *see, e.g., Comm'r of Revenue v. Associated Dry Goods, Inc.*, 347 N.W.2d 36 (Minn. 1984); *Maurice L. Rothschild & Co. v. Comm'r of Taxation*, 270 Minn. 245, 133 N.W.2d 524 (1965); *Great Lakes Pipe Line Co. v. Comm'r of Taxation*, 272 Minn. 403, 138 N.W.2d 612 (1965) *appeal dismissed*, 384 U.S. 718 (1966). The two statutes, Minn. Stat. §§ 290.17, subd. 2(4) and 290.19, subd. 1 (1980), as well as the cases construing them, clearly established that, absent compelling circumstances resulting in unfairness, for the tax years here involved, combined income tax reporting, which in essence would ensue were we to accept NCR's position, by a unitary business was not avail-

able to a corporate taxpayer. *Westinghouse Electric Corp.*, 398 N.W.2d 530 at 537 (Minn. 1986). In addition, we conclude it appears that the Commissioner properly included in NCR's general income, for purposes of the apportionment formula, income payments it received from licensees and subsidiaries.[5]

It does not follow, however, as relator would have us hold, that the subsidiaries' factors likewise should be included in the denominator of the apportionment formula. Indeed, our examination of the statutory language leads us to the opposite conclusion, to-wit: that those factors should be excluded from the denominator of the fraction. Though we acknowledge that in the context of the statute, the appearance of language such as "all," "total" and "wherever located" does afford some credence to relator's position, *see* Minn. Stat. § 290.19, subd. 1 (1980), this language must be considered in context. *See* Minn. Stat. § 645.16 (1988). The statute, for example, refers to total property, wherever located, of "the taxpayer," and to the "taxpayer's" total payrolls. Minn. Stat. § 290.19, subd. 1(b)-(c) (1980). As did the Maryland court, *see NCR Corp.*, 544 A.2d at 777, we conclude that "taxpayer" as used in the apportionment statute did not include foreign subsidiaries not subject to taxation in Minnesota. Minn. Stat. § 290.01, subd. 6 (1980) defines "taxpayer" as a "person or corporation subject to a tax imposed by this chapter [Chapter

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[5] As indicated, NCR initially excluded from its income interest, royalties and dividends received from licensees and subsidiaries, and, the Commission inclusion of those items in the denominator of the apportionment formula fraction originally prompted this appeal. In brief and argument, however, relator has concentrated more on the exclusion of the subsidiaries' factors. Nonetheless, we note that NCR's position with respect to the Commissioner's action is unfounded. Since NCR is a unitary business, its "entire income" is subject to apportionment. Minn. Stat. § 290.17, subd. 2(4) (1980). Moreover, that income specifically must appear in NCR's base income. *See* Minn. Stat. § 290.01, subd. 20 (1980) ("income derived from any source.")

290.]" Moreover, the parties stipulated NCR and its foreign subsidiaries operate as "a single unitary business." We follow Illinois and would define unitary business as "a group of functionally integrated corporate units which are so interrelated and interdependent that it becomes relatively impossible for one state to determine the net income generated by a particular corporation's activities within the state * * *." *Caterpillar Tractor Co. v. Lenckos*, 84 Ill.2d 102, 417 N.E.2d 1343,1351 (1981). Therefore, NCR's foreign subsidiaries, as part of a unitary business group, are included within the term "taxpayer." *See also AT&T Co. v. Wisconsin Dep't of Revenue*, 143 Wis. 2d 533, 422 N.W.2d 629, 632 (Wis. App. 1988) (limiting "taxpayer" to parent of a unitary operation is inconsistent with notion of a unitary business). Both NCR and the Commissioner concede that the income of NCR's foreign subsidiaries is not subject to income taxation in Minnesota. Because NCR is the only "taxpayer" involved in this case, the apportionment statute contemplates that only its factors of property used, payroll paid, and sales made are relevant for inclusion in the denominator of the apportionment fraction. Therefore, NCR's construction argument must be rejected. The Commissioner properly excluded sales made, payroll paid, and property used factors of relator's foreign subsidiaries from the apportionment formula.

2. But if that is so, argues relator, and if Minn. Stat. § 290.19 (1980) is construed to require inclusion of foreign source income in its apportionable income, then the Due Process and Foreign Commerce Clauses of the United States Constitution require at least a portion of its foreign subsidiaries' income generating activities (sales, payroll and property) be included in the denominator of the formula fraction (what NCR refers to as a "correlative adjustment.")[6] The use by states of apportionment formulas has

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[6] In its brief and at oral argument, relator was unable to more precisely define what it contended should be included in this "correlative

been upheld by the United States Supreme Court against constitutional challenge, subject only to the limitation that a state cannot "tax value earned outside its borders." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). A taxpayer alleging a due process violation bears a substantial burden to demonstrate by clear and cogent evidence that the state is taxing income earned outside its jurisdiction. However, a state need not show that its statute results in the precise allocation of income resulting from activities of the taxpayer occurring within its jurisdiction. *Id.* at 169-70.[7]

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adjustment." During the course of this proceeding, NCR has seemingly shifted its position on this issue, lending some support, in our view, to the Commissioner's contention that selection of an apportionment formula is essentially one of policy for legislative resolution.

[7] The test to be used in evaluating due process challenges to apportionment statutes was there explained:

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State • • •" *Moorman Mfg. Co., supra*, 437 U.S., at 272 (emphasis added). *See Underwood Typewriter Co.*, 254 U.S. at 120-121. Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted • • • in that State,' [*Hans Rees' Son, Inc.*,] 283 U.S., at 135, 51 S.Ct., at 398, or has 'led to a grossly distorted result.'

Id. at 169-70.

In denying a similar due process challenge to our apportionment statute formula, we followed the *Container Corp.* analysis in *Westinghouse Elec. Corp.*, 398 N.W.2d at 537 (1986). NCR, as did the taxpayer in *Westinghouse*, here argues that unless the foreign subsidiaries' activities are reflected in the denominator of the apportionment formula fraction, the Minnesota statute violates the Due Process Clause since value earned outside of Minnesota is taxed, or, in other words, that the "internal consistency" requirement of *Container Corp.* is not met because NCR is taxed twice on its foreign income. Relator argues that this double taxation is a reality as a result of being taxed by foreign countries on its foreign source income. By way of illustration, it claims it paid to Canada more than $7 million in withholding taxes on royalties, interest and dividends it received from its Canadian subsidiaries.

Assuming NCR's argument is properly addressed under the Due Process Clause, in our opinion NCR has failed to meet its burden of proof to sustain its internal consistency challenge. We did consider a similar internal consistency argument in *Westinghouse Elec. Corp.*, 398 N.W.2d at 537-38. There, the taxpayer argued that unitary business apportionment, rather than combined reporting with its subsidiaries, resulted in a risk of multiple taxation. *Id.* at 537. In rejecting this argument, we observed that the taxpayer had failed to demonstrate a "real danger of overlap." *Id.* at 538. NCR's argument suffers from that same lack of evidence demonstrating an overlap. It has shown that it paid a tax to Canada on a portion of the income (between 10 and 15 percent) it received from its Canadian subsidiaries. Its tax returns for 1977-1981 reveal it paid approximately 10 percent in withholding taxes to some foreign countries on its foreign source income (dividends and royalties), although taxes were not paid to all countries in which income was received by it. Even so, NCR has not demonstrated that exclusion of the subsidiaries' income producing activities in the denominator of Minnesota's for-

mula would result in more than all of its income being taxed. In our view, NCR has fallen far short of meeting its burden of demonstrating any internal inconsistency of Minnesota's apportionment formula by "clear and cogent" evidence. *See Westinghouse Elec. Corp.*, at 538. Realizing that such attempts to equitably apportion income are often less than meticulously precise, the Supreme Court of the United States has allowed states wide latitude in the structuring and use of statutory apportionment formulas. *See, e.g., Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978).

The *Container Corp.* test also contains a requirement of "external consistency." For an apportionment statute to meet this requirement, the factors used in the apportionment formulas must actually reflect a reasonable sense of how income is generated. *Id.* at 169-70, or, to state it another way, that the taxpayer's income attributed to the state is proportional to the taxpayer's business conducted within the state. NCR argues that by excluding the subsidiaries' factors in the formula fraction, its income allocated to Minnesota will be overstated. Its position in this regard is reflected in Justice Stevens' dissent in *Mobil Oil Corp. v. Comm'r of Taxation*, 445 U.S. 425 (1980) wherein he opined that exclusion of sales made, payroll paid, and property used of subsidiaries from an apportionment formula that includes income attributable to those subsidiaries will inevitably result in external inconsistency.[8]

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[8] In that dissent, his views were stated as follows:

> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.
>
> Either Mobil's worldwide "petroleum enterprise," is all part of one unitary business, or it is not; if it is, Vermont must evaluate the entire enterprise in a consistent manner. As

However, Justice Stevens' reasoning was apparently followed in *AT&T Co. v. Dep't of Revenue*, 422 N.W.2d 629 (Wis. App. 1988), where the Wisconsin appellate court held that exclusion of a corporate taxpayer's subsidiaries' income producing activities from the denominator rendered the Wisconsin apportionment formula externally inconsistent because its application apportions to Wisconsin "far too much income from the Bell system in relation to its property located here, its sales here or its payroll." *Id.* at 636. The Wisconsin court notes that courts have not authoritatively dealt with the issue so as to provide guidance, but it relied not only on Justice Stevens' dissent in *Mobil Oil Corp.*, but also on writings of several commentators. *Id.* at 635. *See, e.g.*, Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 Nat'l Tax J. 487, 496 (1968); Keesling, *The Impact of the Mobil Case on Apportionment of Income*, 1981 B.Y.U.L. Rev. 87, 101. NCR has likewise been at least partially successful in advancing Justice Stevens' view in Maryland. In *NCR Corp.*, the appellate court remanded the case directly to its tax court to determine whether the alleged distortion occurring from the exclusion of subsidiary factors in the denominator was of "constitutional dimensions." *NCR Corp.*, 544 A.2d at 781.

Though never addressing this precise issue, the United States Supreme Court has indicated that not every claimed distortion will give rise to an external inconsistency of a constitutional magnitude. Rather, to justify a finding of impermissible external consistency, any alleged distortion must be demonstrated to be outside the "substantial margin of error." *Container Corp.*, 463 U.S. at 184, (noting

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> it is, it has indefensibly used its apportionment methodology artificially to multiply its share of Mobil's 1970 taxable income perhaps as much as tenfold.

Id. at 461. That viewpoint, however, has never been adopted by the Supreme Court of the United States.

that while it had previously invalidated a formula resulting in a 250 percent difference, it upheld the 14 percent difference in *Container*.)

NCR attempts to illustrate its claim here of gross distortion resulting from the Commissioner's formula by comparing its net taxable income subject to apportionment to its foreign subsidiaries' property used, payroll paid, and sales made figures for 1981. NCR then concludes, based on that comparison, that for 1981, foreign source income represented 49 percent of its net taxable income, yet no indication of how that 49 percent income was generated appears to be reflected in the formula. On the other hand, the Commissioner argues that NCR's approach is improper. Rather, he contends, the correct approach is to compare the difference between tax liability resulting from different applications of the formula. When that is done, the increase in NCR's taxes resulting from application of this approach is an average of approximately 23 percent, which he argues, is within the acceptable margin of error the Supreme Court recognized in *Container Corp.* We agree that the Commissioner's comparison calculations resulting from his employment of the generally accepted method of addressing the external consistency requirement, *see, e.g., Container Corp.*, 463 U.S. at 183; *Westinghouse*, 398 N.W.2d at 537, more accurately reflects any claimed tax disparity. The result reached from its application is within the "acceptable margin of error," and certainly does not approach the disparity the Supreme Court of the United States found constitutionally unacceptable in *Hans Rees Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931). Thus, we hold that NCR has failed to demonstrate by clear and cogent evidence that the relatively small resulting disparity in tax fails to properly reflect how the income was generated, or, that an excessive amount of that income was attributed to Minnesota under proper application of its apportionment statute to be constitutionally impermissible.

3. Finally, NCR argues that application of Minnesota's apportionment statute results in the possibility of multiple taxation if its subsidiaries' income is taxed under the formula in Minnesota and, as well, taxed by the foreign countries in which those subsidiaries do business. Therefore, NCR argues, it violates the Foreign Commerce Clause of the United States Constitution, art. I, § 8, cl. 3. The Supreme Court of the United States rejected a similar argument advanced by the taxpayer in *Container Corp.* In doing so, it reiterated the standards it had enumerated in *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).[9]

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[9] In discussing this issue, the court stated:

> The first [consideration] is the enhanced risk of multiple taxation. Although consistent application of the fair apportionment standard can generally mitigate, if not eliminate, double taxation in the domestic context,
>
> > neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results * * *.
>
> The second additional consideration that arises in the foreign commerce context is the possibility that a state tax will "impair federal uniformity in an area where federal uniformity is essential."
>
> > A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity * * *. If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from "speaking with one voice" in regulating foreign commerce.

NCR contends here that the risk of multiple taxation is readily apparent because it is subject to income withholding taxes on its foreign source income by foreign countries in which its subsidiaries operate, and, in fact, has paid such tax and that, therefore, pursuant to *Japan Line*, it is clear that it is exposed to double taxation. We disagree. The tax in question in *Japan Line* was a property tax. The distinction between a Commerce Clause analysis involving a property tax and an income tax analysis based upon an apportionment formula is a most significant factor for determining whether a risk of multiple taxation is constitutionally acceptable.[10]

NCR acknowledges the distinction between property and income taxes delineated by the court in *Container Corp.* Nevertheless, it contends that even when considering income taxes, multiple taxation "could be avoided" by incorporating the subsidiaries' income producing factors in the formula. It appears to us that in any income tax apportionment formula continual risk of multiple taxation exists. However, a constitutional analysis does not require a state to apply a different formula simply because the

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Container Corp., 463 U.S. at 185-86, *quoting Japan Line*, 441 U.S. at 447-51 (citations omitted).

[10] For example, in *Container Corp.*, which did involve an income tax apportionment statute, the court explained:

> That California would have trouble avoiding double taxation even if it adopted [a different formula] is, we think, a product of the difference between a tax on income and a tax on tangible property. * * * Allocating income among various jurisdictions bears some resemblance * * * to slicing a shadow. In the absence of a central coordinating authority, absolute consistency, even among taxing authorities whose basic approach to the task is quite similar, may just be too much to ask.

Container Corp., 463 U.S. at 192.

risk *may* be lower.[11] Even assuming that NCR is correct in its contention that inclusion of subsidiaries' factors in the formula would more accurately reflect the taxpayer's activities within the state, the argument relates more appropriately to its due process claim. Even so, we are unable to reach a conclusion that its adoption would *prevent* multiple taxation, the evil to be avoided under *Japan Line*. Rather, its contention merely presents an option between two variations of the formula, neither one of which can be found to be completely precise in avoiding overlapping taxation. Therefore, we conclude its contention in that respect must fail.

The second consideration under *Japan Line* is whether the statutory formula as applied by the Commissioner impairs federal uniformity. This issue relates to whether a state tax implicates foreign policy issues or violates a clear federal directive. *Container Corp.* 463 at U.S. at 194. NCR argues that the federal government cannot take a uniform position on taxation vis-a-vis, foreign nations when the individual states and other political subdivision are pursuing divergent procedures, and illustrates the position the federal government is then placed in by reference to tax treaties which the nation has entered into with other foreign nations. Again, the *Container Corp.* court rejected a similar argument, observing that such tax policy decisions

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[11] As the Supreme Court of the United States observed in *Container Corp.*:

> If California's method of formula apportionment "inevitably" led to double taxation, * * *that might be reason enough to render it suspect. But since it does not, it would be perverse, simply for the sake of avoiding double taxation to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation.

Id. at 192-93.

generally lie within the province of the federal executive and legislative branches. *See Container Corp.*, 463 U.S. at 195-96.

NCR has provided us with no evidence of any clear federal directive which precludes Minnesota from applying its apportionment formula as it did. Whether any alleged increased tax liability affects federal foreign policy is, as observed by the Supreme Court of the United States, more appropriately addressed by other branches of the government.

Because we conclude the Commissioner correctly interpreted Minn. Stat. § 290.19 (1980), and that his interpretation did not violate either the Due Process or the Commerce Clause of the United States Constitution, we affirm the Tax Court.

KEITH, Justice, took no part in the consideration or decision of this case.

STATE OF MINNESOTA
IN SUPREME COURT
C2-88-762

NCR Corporation,

Relator,

vs.

Commissioner of Revenue,

Respondent.

ORDER

This court, having considered en banc the petition for rehearing in the above-entitled cause,

IT IS ORDERED that the petition for rehearing be and hereby is denied.

IT IS FURTHER ORDERED that attorney fees are not allowed to any party on this petition pursuant to Rule 140, Rules of Civil Appellate Procedure.

Dated: April 14, 1989.

BY THE COURT:

/s/ Glenn E. Kelley
Glenn E. Kelley, Associate Justice

Justice Keith took no part in the consideration or decision of this case.

OFFICE OF
APPELLATE COURTS
APR 14 1989
FILED

APPENDIX B

P.O. Box 64452 - St. Paul, Minnesota 55164
Phone: Twin Cities 296-3781. Elsewhere in Minnesota, call toll-free: 1-800-652-9094

Notice of Change in Your Tax

Notice date 9-21-84
Minnesota identification no. B-8663626
Federal identification no. (if any) 31-0387920

NCR Corporation
1700 So Patterson Blvd
Dayton Oh 45479

We have reviewed your income tax return for the year(s) shown below. This review resulted in a change in the amount of refund you are entitled to receive or tax you must pay.

If the box checked in the upper left corner of this form shows that the review resulted in a proposed change in your income tax, you will find an audit report enclosed describing the change. If you have a question about the report, or believe that a mistake was made, or that all information was not taken into consideration in making the change, you can write to the address listed at the top of this form or call one of the numbers listed above. If, after contacting the Department of Revenue, you still do not agree with the change to your tax, you can protest the change.

The taxpayer review period shown in the upper right corner of this form is the period of time during which you may protest the change with the Department. Use the protest form on the back of Copy A. If you have questions about how to fill out the protest form, you may call one of the numbers listed above.

After the notice date shown in the upper right hand corner has passed, you may appeal the change made to your

income tax to the Tax Court whether there was a taxpayer review period or not. You have up to 60 days from the notice date to file your appeal with the Tax Court. If the amount you owe is more than $6,000, you must pay the entire amount when it is due unless you have the court's permission to appeal without payment.

If you decide to appeal, you may choose to have your case heard in the regular Tax Court or to have it heard informally by a Tax Court judge in the small claims division. However, in order to appeal to the small claims division, the amount of your tax, penalty and interest in dispute cannot be more than $2,500. A decision made in the small claims division is final and cannot be appealed by you or the Department of Revenue. You can get the forms you need to file your appeal by going in person or by writing to: Tax Court, Space Center Building, Fifth Floor, 444 Lafayette Road, St. Paul, Minnesota 55101. You can also get the forms to file your appeal from the District Court Clerk in your county.

If you must pay an additional amount of tax because of this notice and/or proposal and if you do not pay the tax within 60 days from the notice made, a penalty will be added to the amount of the unpaid tax. In addition to the penalty, interest will be added both to the amount of your unpaid liability and to your penalty.

If you are entitled to a refund, it will be applied to any other Minnesota taxes you owe. If you owe a debt to another state agency or a county agency or if you owe any felony criminal fines, your refund may also be used to pay that debt. If your refund is larger than the amount you owe you will receive a check for the difference in about 30 days.

/s/ G. T. Caulfield
G. T. Caulfield, Director
Corporation Income Tax Division
(612) 296-3441

lmr

Computation of the Change in Your Income Tax

Tax year	Account number	Increase or (Decrease)	Tax	Penalty	Interest	Total
12-31-74	115696 GAK EHR	Reduction in Tax	$ 195.00	$	$	$
		Reduction in Int.	67.13		54.98	< 317.11 >
12-31-77	18765 GAK EHR	Additional Tax	4,568.00		3,259.03	7,827.03
12-31-78	55333 GAK EHR	Additional Tax	46,320.00		29,341.53	75,661.53
12-31-78	55333 GAK EHR	Additional Tx Chge	7,537.94			7,537.94
12-31-79	96723 GAK EHR	Additional Tax	58,115.00		32,151,17	90.266.17
12-31-80	138738 GAK EHR	Additional Tax	14,634.00		6,928.50	21,562.50
12-31-81	172760 GAK EHR	Additional Tax	84,879.00		32,223.87	117,102.87

(See audit report previously mailed 2-6-84)

Net Increase $319,640.93

MINNESOTA TAX COURT FORM 1

TAX COURT—Notice of Appeal of An Order of the Commissioner of Revenue. Minn. Statutes CH. 271.

Date of Order: 9/21/84

Account Number: B-8663626

Social Security No.: (if applicable)

STATE OF MINNESOTA COUNTY OF Ramsey
TAX COURT DIVISION: Tax Court (Regular)

NCR Corporation, Appellant VS. Commissioner of Revenue, Appellee

1. Your Appellant represents and shows to the Court: (state reasons for your appeal)

See Addendum Attached.

2. Attach a copy of the order appealed from.

WHEREFORE, your Appellant(s) pray(s) this Honorable Court for determination on Appellants' claim.

/s/ D. W. Russler
Appellant

ADDRESS AND PHONE:
(Or Attorney's Name, Address & Phone)

NCR Corporation
1700 S. Patterson Blvd.
Dayton, Ohio 45479

INSTRUCTIONS

1. A Notice of Appeal must be filed in the Tax Court's St. Paul office or with the clerk of district court in the county of taxpayer's residence within 60 days of the date of the Commissioner's order. Preferably, file the appeal, either in person or by mail, at the St. Paul office of the Tax Court.

2. If the amount of tax in issue is less than $2500, taxpayer has the option of appealing to either the regular

or small claims division of Tax Court. If an appeal is made to the small claims division, the judgment of the Tax Court is conclusive upon all parties and may not be appealed. If the amount of tax in issue is over $2500, taxpayer must appeal to the regular division of Tax Court.

3. A notarized affidavit of service must be filed with the Notice of Appeal, stating that a copy of the Notice of Appeal has either been mailed or delivered in person to the Commissioner of Revenue. Examples of affidavits for either method of service are attached hereto.

4. Filing fees are $25 for the regular division and $2 for the small claims division of the Tax Court. If the appeal is filed at the District Court, there may be an additional library fee charged.

5. Any clerk of the Tax Court, for cause shown, may by written order extend the time for appealing 30 days. The extension must be requested within 60 days of the date of the Commissioner's order.

6. The address of Tax Court is 5th Floor, Space Center, 444 Lafayette Road, St. Paul, Minnesota 55101. Our phone number is (612) 296-2806.

7. The address of the Commissioner of Revenue is Centennial Office Building, 658 Cedar Street, St. Paul, Minnesota 55145.

8. Please indicate whether you want the case heard by the Tax Court in your District Court or at the Tax Court's hearing room in St. Paul.

AFFIDAVIT OF SERVICE BY MAIL

STATE OF Ohio
COUNTY OF Montgomery

D.W. Russler, being duly sworn, deposes and says that on the ___ day of November, 1984, he served the attached Notice of Appeal on the Commissioner of Revenue for the State of Minnesota by placing a true and correct copy thereof in an envelope and addressing the same as follows: Commissioner of Revenue, Department of Revenue, Centennial Office Building, St. Paul, Minnesota 55145, and deposited the same with postage prepaid in the United States mail at Dayton, Ohio 45479

Subscribed and sworn to before me this 16th day of November, 1984.

/s/ D. W. Russler
Appellant

MARY ANNE WHITT, Notary Public
In And For The State of Ohio
My Commission Expires March 18, 1988

/s/ Mary Anne Whitt
Notary Public

Addendum

NCR Corporation objects to the assessment for the years 1977 and 1978 on the basis that Minnesota is without authority under the statute to assess.

NCR Corporation hereby objects to the inclusion of foreign royalty income in apportionable income; however, if it is determined to be apportionable then it is our position that the receipts (sales), by the foreign subsidiaries that gave rise to this income should be included in the factors.

NCR Corporation hereby objects to the taxation of 15%of the foreign subsidiary dividends and takes the position that if the dividends are taxable then all the property, payroll and sales of the foreign subsidiaries should be included in the factors. NCR Corporation further objects to the taxation of Subpart F Income.

NCR Corporation further takes the position that if 50% of the capital gains are to be apportioned then at least 50% of the receipts applicable to that gain should be included in the sales factor and 50% of the value of the property should be included in the property factor. NCR Corporation further objects to the taxation of the portion of the gains which were taxed 100% in Pennsylvania.

STATE OF MINNESOTA
IN SUPREME COURT

NCR CORPORATION,

Relator,

vs.

COMMISSIONER OF REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI
SUPREME COURT NO: C2-88-762

TAX COURT NO: 4224

DATE OF SERVICE OF WRITTEN NOTICE OF DECISION: March 15, 1988

TO: The Supreme Court of the State of Minnesota:

The above-named relator hereby petitions the Supreme Court for a Writ of Certiorari to review a decision of the Tax Court, upon the grounds that it is not in conformity with the law.

DATED: April 11, 1988.

HART, BRUNER & O'BRIEN, P.A.

BY /s/ James W. Littlefield
James W. Littlefield, #63927
1221 Nicollet Mall, Suite 700
Minneapolis, MN 55403
(612) 332-1431

ATTORNEY FOR RELATOR,
NCR CORPORATION

OFFICE OF
APPELLATE COURTS
APR 11 1988
FILED

STATE OF MINNESOTA
IN SUPREME COURT

NCR CORPORATION,

Appellant,

vs.

COMMISSIONER OF REVENUE,

Respondent.

STATEMENT OF THE CASE OF APPELLANT
SUPREME COURT NO:

TAX COURT NO: 4224

DATE OF SERVICE OF WRITTEN NOTICE OF DECISION: March 15, 1988

1. This case was decided by Chief Judge Earl B. Gustafson, Minnesota Tax Court.

2. Jurisdiction to review the final judgment of the Tax Court in this case is conferred upon this Court by Minn. Stat. § 271.10

3. Corporate income tax, Minn. Stat. § 290.19 and the Commerce and Due Process Clauses of the Unites [sic] States Constitution, Article I, § 8, cl. 3 and Amendment XIV, § 1.

4. Two questions were presented to the Tax Court:

(1) Whether the fact that Minnesota includes in NCR's apportionable income the dividends, interest and royalties received by NCR from its foreign subsidiaries necessitates the inclusion of the net sales, payroll, and properties of the foreign subsidiaries in the sale, payroll and property factors of Minnesota's three-factor apportionment formula?

(2) Whether the fact that Minnesota subjects to tax a portion of the dividends received by NCR from its foreign subsidiaries, while excluding wholly from tax the dividends received by NCR from subsidiaries doing

only an intrastate business, creates a constitutionally-proscribed discrimination against interstate and foreign commerce?

Appellant NCR contended that each question should be answered affirmatively while respondent Commissioner of Revenue contended that each question should be answered negatively.

The Minnesota Tax Court answered the first question negatively and as to the second question, while of the opinion that it should be answered affirmatively, concluded that it could not do so because of its inherent lack of jurisdiction to declare a statute unconstitutional.

5. The issue proposed to be raised on appeal is whether the Tax Court erred in its conclusion that when Minnesota subjects foreign dividend, interest and royalty income to formula apportionment, neither the United States Constitution nor the Minnesota statutes compel the inclusion within the apportionment formula of the net sales, payroll and property factors of the payors of such income.

6. A transcript is not required.

7. Oral argument is requested.

8. Formal briefs are necessary.

9. Appellant's attorney is:

James W. Littlefield
Hart, Bruner & O'Brien, P.A.
1221 Nicollet Mall, Suite 700
Minneapolis, MN 55403
(612) 332-1431

Respondent's attorney is:

Thomas R. Muck
Deputy Attorney General
Department of Revenue

P.O. Box 64446
Centennial Office Building
St. Paul, MN 55164
(612) 296-3421

DATED: April 11, 1988.

HART, BRUNER & O'BRIEN, P.A.

BY /s/ James W. Littlefield
James W. Littlefield, #63927
1221 Nicollet Mall, Suite 700
Minneapolis, MN 55403
(612) 332-1431

ATTORNEY FOR RELATOR,
NCR CORPORATION

APPENDIX C

290.19 NET INCOME; ALLOCATION TO STATE, METHODS. Subdivision 1. **Computation, business conducted partly within state; apportionment.** The taxable net income from a trade or business carried on partly within and partly without this state shall be computed by deducting from the gross income of such business, wherever derived, deductions of the kind permitted by section 290.09, so far as connected with or allocable against the production or receipt of such income. The remaining net income shall be apportioned to Minnesota as follows:

(1) If the business consists of the mining, producing, smelting, refining, or any combination of these activities of copper and nickel ores, or of the manufacture of personal property and the sale of said property within and without the state, the remainder shall be apportioned to Minnesota on the basis of the percentage obtained by taking the arithmetical average of the following three percentages:

(a) The percentage which the sales made within this state is of the total sales wherever made;

(b) The percentage which the total tangible property, real, personal, and mixed, owned or rented, and used by the taxpayer in this state during the tax period in connection with such trade or business if of the total tangible property, real, personal, or mixed, wherever located, owned or rented and, used by the taxpayer in connection with such trade or business during the tax period; and,

(c) The percentage which the taxpayer's total payrolls paid or incurred in this state or paid in respect to labor performed in this state in connection with such trade or business is of the taxpayer's total payrolls paid or incurred in connection with such entire trade or business;

(d) The percentage of such remainder to be assigned to this state shall not be in excess of the sum of the following

percentages: 70 percent of the percentage determined under clause (1) (a), 15 percent of the percentage determined under clause (1) (b), and 15 percent of the percentage determined under clause (1) (c).

(2) (a) In all other cases the remainder shall be apportioned to Minnesota on the basis of the percentage obtained by taking the arithmetical average of the following three percentages:

(1) The percentage which the sales, gross earnings, or receipts from business operations, in whole or in part, within this state bear to the total sales, gross earnings, or receipts from business operations wherever conducted;

(2) The percentage which the total tangible property, real, personal, and mixed, owned or rented, and used by the taxpayer in this state during the tax period in connection with such trade or business is of the total tangible property, real, personal, or mixed, wherever located, owned, or rented, and used by the taxpayer in connection with such trade or business during the tax period; and

(3) The percentage which the taxpayer's total payrolls paid or incurred in this state or paid in respect to labor performed in this state in connection with such trade or business is of the taxpayer's total payrolls paid or incurred in connection with such entire trade or business;

(4) The percentage of such remainder to be assigned to this state shall not be in excess of the sum of the following percentages: 70 percent of the percentage determined under clause (2) (a) (1), 15 percent of the percentage determined under clause (2) (a) (2), and 15 percent of the percentage determined under clause (2) (a) (3);

(b) If the methods prescribed under clause (2) (a) will not properly reflect taxable net income assignable to the state, there may be used, if practicable and if such use will properly and fairly reflect such income, the percentage which the sales, gross earnings, or receipts from business

operations, in whole or in part, within this state bear to the total sales, gross earnings, or receipts from business operations wherever conducted; or the separate or segregated accounting method;

(3) The sales, payrolls, earnings, and receipts referred to in this section shall be those for the taxable year in respect of which the tax is being computed. The property referred to in this section shall be the average of the property owned or used by the taxpayer during the taxable year in respect of which the tax is being computed.

Subd. 1a. **Determination of sales made within this state.** For purposes of this section the following rules shall apply in determining whether or not sales are made within this state.

Sales of tangible personal property are made within this state if the property is delivered or shipped to a purchaser within this state, and the taxpayer is taxable in this state, regardless of the f.o.b. point or other conditions of the sale.

Sales made by or through a corporation which is qualified as a domestic international sales corporation under section 992 of the Internal Revenue Code of 1954, as amended through December 31, 1974, shall not be considered to have been made within this state.

Subd. 2. **Application of methods.** The methods prescribed by subdivision 1 shall apply wherever and insofar as the business carried on within this state is an integral part of a business carried on both within and without this state.

Subd. 3. **Application of sections 290.17 and 290.18.** Nothing in this section shall prevent the application of sections 290.17 and 290.18 to that portion of a taxpayer's income which is not from a trade or business carried on partly within and partly without this state.

STATE TAXATION OF FOREIGN-SOURCE DIVIDENDS

STATE[1]	NOT SUBJECT TO TAX	EXCLUDED FROM APPORTIONABLE INCOME	INCLUDED IN APPORTIONABLE INCOME[2]
Alabama		x	
Alaska - Worldwide Combination			x
Arizona	x		
Arkansas			x
California			x
Colorado			x
Connecticut	x		
Delaware	x		
District of Columbia			x
Florida	x		
Georgia	x		
Hawaii			x
Idaho			x
Illinois			x
Indiana			x
Iowa			x
Kansas			x
Kentucky	x		
Louisiana		x	
Maine			x

Maryland			x
Massachusetts			x
Michigan	x		
Minnesota			x
Mississippi			x
Missouri			x
Montana			x
Nebraska	x		
Nevada	x		
New Hampshire			x
New Jersey			x
New Mexico			x
New York			x
North Carolina		x	
North Dakota			x
Ohio	x		
Oklahoma		x	
Oregon			x
Pennsylvania	x		
Rhode Island			x
South Carolina		x	
South Dakota	x		
Tennessee			x
Texas	x		
Utah			x

STATE[1]	NOT SUBJECT TO TAX	EXCLUDED FROM APPORTIONABLE INCOME	INCLUDED IN APPORTIONABLE INCOME[2]
Vermont			x
Virginia			x
Washington	x		
West Virginia	x		
Wisconsin			x
Wyoming	x		

[1] Nevada, South Dakota, Texas, Washington, and Wyoming do not impose a corporate income tax. Ala. Code Sec. 40-18-34, 40-18-33(14); Alaska Stat. Sec. 43.20.065; Ariz. Rev. Stat. Ann. Sec. 43-1122(8); Ark. Stat. Ann. 26-51-404(b)(9); Cal. Rev. & Tax Code Sec. 24411; Colo. Rev. Stat. Sec. 39-22-304, 39-22-303(10); Conn. Gen. Stat. Sec. 12-217(a)(D); Del. Code Ann. Title 30, Sec. 1903(a)(2); D.C. Code Ann. Sec. 47-1810.1; Fla. Stat. Sec. 220.13(1)(b)2.a, ch 84-549; Ga. Code Ann. Sec. 48-7-21(b)(9); Hawaii Rev. Stat. Sec. 235-7(c); Idaho Code Sec. 63-3027C; Ill. Rev. Stat. Ch. 120 Sec. 2-203(b)(2)(0); Ind. Rev. Stat. Sec. 6-3-2-12; Code of Iowa Sec. 422.35; Kansas Stat. Ann. Sec. 79-32,138(c)(vi); Kent. Rev. Stat. Sec. 141.010(12)(b); La. Rev. Stat. Ann. Sec. 242(1)(d), 243.A(4); Me. Rev. Stat. Ann. Title 36 Sec. 5102.8; Md. Ann. Code Sec. 10-307; Mass. Gen. Laws. Ann. Ch. 63 Sec. 38(a)(1); Mich. Comp. Laws Sec. 208.9(4)(d); Minn. Stat. Ann. Sec. 290.21 Subd. 4; Miss. Code Ann. Sec. 27-7-15(1), 27-7-15(4)(i); Mo. Rev. Stat. Sec. 143.431; Mont. Code Ann. Sec. 15-31-325; Nebr. Rev. Stat. Sec. 77-2716(5); N.H. Rev. Stat. Ann. Sec. 77-A:3.II(b); N.J. Stat. Ann. Sec. 54:10A-4(k)(1); N.M. Stat. Ann. Sec. 7-2A-8; N.Y. Tax Law Sec. 208(9); N.C. Gen. Stat. Sec. 105-130.7, 105-130.4(f); N.D. Cent. Code Sec. 57-38-1-07 and -09; Ohio Rev. Code Ann. Sec. 5733.04(I)(2); Okla. Stat. Title 68 Sec. 2358.A.4.b and .5; Or. Rev. Stat. Sec. 317.267(2); 72 Pa. Stat. Ann. Sec. 7401(3)1.(a) and (b); R.I. Gen. Laws Sec. 44-11-11, 44-11-12; S.C. Code Ann. Sec. 12-7-1120(2); Tenn. Code Ann. Sec. 67-4-805(b)(2)(A); Utah Code Ann. Sec. 59-7-106(2)(d)(i); Vt. Stat. Ann. Title 32 Sec. 5811(18); Va. Code Sec. 58.1-408; W.V. Code Sec. 11-24-6(c)(10); Wisc. Stat. Ann. Sec. 71.04(4).

[2] This column includes States that include foreign-source dividends, in part or in whole, in apportionable income. Some of these States provide a partial deduction for dividends received from affiliates.

STATE TAXATION OF FOREIGN-SOURCE INTEREST INCOME

STATE[1]	NOT SUBJECT TO TAX	EXCLUDED FROM APPORTIONABLE INCOME	INCLUDED IN APPORTIONABLE INCOME
Alabama			x
Alaska - Worldwide Combination			x
Arizona			x
Arkansas			x
California			x
Colorado			x
Connecticut			x
Delaware		x	
District of Columbia			x
Florida			x
Georgia			x
Hawaii			x
Idaho			x
Illinois			x
Indiana			x
Iowa			x
Kansas			x
Kentucky			x
Louisiana		x	
Maine			x

STATE[1]	NOT SUBJECT TO TAX	EXCLUDED FROM APPORTIONABLE INCOME	INCLUDED IN APPORTIONABLE INCOME
Maryland			x
Massachusetts			x
Michigan	x		
Minnesota			x
Mississippi			x
Missouri			x
Montana			x
Nebraska			x
Nevada	x		
New Hampshire			x
New Jersey			x
New Mexico			x
New York			x
North Carolina			x
North Dakota			x
Ohio	x		
Oklahoma			x
Oregon			x
Pennsylvania			x
Rhode Island			x

South Carolina				x
South Dakota	x			
Tennessee				x
Texas	x			
Utah				x
Vermont				x
Virginia				x
Washington	x			
West Virginia	x			
Wisconsin				x
Wyoming	x			

[1] Nevada, South Dakota, Texas, Washington, and Wyoming do not impose a corporate income tax. Ala. Code Sec. 40-18-34, Reg. 810-3-31-.02(v); Alaska Stat. Sec. 43.19.010 Art. IV (7) and (9); Ariz. Rev. Stat. Ann. Sec. 43-1134, 43-1137 and 43-1139; Ark. Stat. Ann. Sec. 26-51-707 and 26-51-709; Cal. Rev. & Tax Code Sec. 25126 and 25128; Colo. Rev. Stat. Sec. 24-60-1301, Art. IV, Par. 7 and 9; Conn. Gen. Stat. Sec. 12-213 and 12-217; Del. Code Ann. Title 30, Sec. 1903(b)(5); D.C. Code Ann. Sec. 47-1810.2(c)(4) and (d); Fla. Stat. Sec. 220.13; Ga. Code Ann. Sec. 48-7-31(b) to (d); Hawaii Rev. Stat. Sec. 235-27 and 235-29; Idaho Code Sec. 63-3027(g) and (i); Ill. Rev. Stat. Ch. 120, Sec. 3-304(a); Ind. Code Ann. Sec. 6-3-2-2(b) and (j); Code of Iowa Sec. 422.33(2)(a)(1), 422.33(2)(b)(1); Kansas Stat. Ann. Sec. 79-3277, 79-3278(b); Kent. Rev. Stat. Sec. 141.120(6), 141.120(8); La. Rev. Stat. Ann. Sec. 242(1)(C) and 243(A)(4); Me. Rev. Stat. Ann. Title 36, Sec. 5211(3) and (8); Md. Ann. Code Sec. 10-402, Reg. 03.04.01.03; Mass. Gen. Laws Ann. Ch. 63, Sec. 38(c); Mich. Comp. Laws Sec. 208.9.7b; Minn. Stat. Ann. Sec. 290.17 Subd. 6, 290.191 Subd. 1; Miss. Code Ann. Sec. 27-7-23(c)(2)(B), 27-7-23(c)(4)(F); Mo. Rev. Stat. Sec. 143.431(1); Mont. Code Ann. Sec. 15-31-304(4), 15-31-305; Nebr. Rev. Stat. Sec. 77-2734.06; N.H. Rev. Stat. Ann. Sec. 77-A:1(II), (IV) and (XIV), 77-A:4; N.J. Stat. Ann. Sec. 54:10E4(i); N.M. Stat. Ann. Sec. 7-2A-8; N.Y. Tax Law Sec. 208(9); N.C. Gen. Stat. Sec. 105-130.4(f), 105-130.4(i); N.D. Cent. Code Sec. 57-38.1-07, 57-38.1-09; Ohio Rev. Code Ann. Sec. 5733.04I; Oklahoma Stat. Title 68, Sec. 2358(A)(4)(b) and (5); Or. Rev. Stat. Sec. 314.640, 314.650; 72 Pa. Stat. Ann. Sec. 401(3)2.(a)(4) and (9); R.I. Gen. Laws Sec. 44-11-14; S.C. Code Ann. Sec. 12-7-1120(1), 12-7-1140; Tenn. Code Ann. Sec. 67-4-810(d), 67-4-811(a); Utah Code Ann. Sec. 59-7-309, 59-7-311; Vt. Stat. Ann. Title 32, Sec. 5833(a); Va. Code Sec. 58-1-408; W.V. Code Sec. 11-24-6(c)(10)(A); Wisc. Stat. Ann. Sec. 71.25(a)(9).

STATE TAXATION OF FOREIGN-SOURCE ROYALTY INCOME

STATE[1]	NOT SUBJECT TO TAX	EXCLUDED FROM APPORTIONABLE INCOME	INCLUDED IN APPORTIONABLE INCOME
Alabama			x
Alaska - Worldwide Combination			x
Arizona			x
Arkansas			x
California			x
Colorado			x
Connecticut			x
Delaware		x	
District of Columbia			x
Florida			x
Georgia			x
Hawaii			x
Idaho			x
Illinois			x
Indiana			x
Iowa			x
Kansas			x
Kentucky			x
Louisiana		x	
Maine			x

Maryland		X
Massachusetts		X
Michigan	X	
Minnesota		X
Mississippi		X
Missouri		X
Montana		X
Nebraska		X
Nevada	X	
New Hampshire		X
New Jersey		X
New Mexico		X
New York		X
North Carolina		X
North Dakota		X
Ohio	X	
Oklahoma		X
Oregon		X
Pennsylvania		X
Rhode Island		X
South Carolina		X
South Dakota	X	
Tennessee		X
Texas	X	
Utah		X

STATE[1]	NOT SUBJECT TO TAX	EXCLUDED FROM APPORTIONABLE INCOME	INCLUDED IN APPORTIONABLE INCOME
Vermont			x
Virginia			x
Washington	x		
West Virginia	x		
Wisconsin			x
Wyoming	x		

[1] Nevada, South Dakota, Texas, Washington, and Wyoming do not impose a corporate income tax. Ala. Code Sec. 40-18-34, Reg. 810-3-31-.02(v); Alaska Stat. Sec. 43.19.010 Art.IV (8) and (9); Ariz. Rev. Stat. Ann. Sec. 43-1134, 43-1138 and 43-1139; Ark. Stat. Ann. Sec. 26-51-708 and 709; Cal. Rev. & Tax Code Sec. 25127 and 25128; Colo. Rev. Stat. Sec. 24-60-1301, Art. IV, Par. 8 and 9; Conn. Gen. Stat. Sec. 12-213 and 12-217; Del. Code Ann. Title 30, Sec. 1903(b)(2); D.C. Code Ann. Sec. 47-1810.2(c)(5)(A) and (d); Fla. Stat. Sec. 220.13; Ga. Code Ann. Sec. 48-7-31(b), 48-7-31(c) & 48-7-31(d); Hawaii Rev. Stat. Sec. 235-28 and 235-29; Idaho Code Sec. 63-3027(h), 63-3027(i); Ill. Rev. Stat. Ch. 120, Sec. 3-303(d), 3-304(a); Ind. Code Ann. Sec. 6-3-2-2(b) and (k)(1); Code of Iowa Sec. 422.33(2)(a)(1), 422.33(2)(b)(1); Kansas Stat. Ann. Sec. 79-3278, 79-3278(b); Kent. Rev. Stat. Sec. 141.120(7), 141.120(8); La. Rev. Stat. Ann. Sec. 242(1)(e), 243(A)(5); Me. Rev. Stat. Ann. Title 36, Sec. 5211(3) and (8); Md. Ann. Code Sec. 10-402, Reg. 03.04.01.03; Mass. Gen. Laws Ann. Ch 63, Sec. 38(c); Mich. Comp. Laws Sec. 208.9.7a; Minn. Stat. Ann. Sec. 290.17 Subd. 6, 290.191 Subd. 1; Miss. Code Ann. Sec. 27-7-23(c)(2)(B), 27-7-23(c)(4)(G); Mo. Rev. Stat. Sec. 143.431(1); Mont. Code Ann. Sec. 15-31-304(5)(a), 15-31-305; Nebr. Rev. Stat. Sec. 77-2734.06; N.H. Rev. Stat. Ann. Sec. 77-A:1(II), (IV) and (XIV), 77-A:4; N.J. Stat. Ann. Sec. 54:10E4(i); N.M. Stat. Ann. Sec. 7-2A-8; N.Y. Tax Law Sec. 208(9); N.C. Gen. Stat. Sec. 105-130.4(g)(1), 105-130.4(i); N.D. Cent. Code Sec. 57-38.1-08.1, 57-38.1-09; Ohio Rev. Code Ann. Sec. 5733.04(I)(2); Okla. Stat. Title 68, Sec. 2358(A)(4)(b) and (5); Or. Rev. Stat. Sec. 314.645(1), 314.650; 72 Pa. Stat. Ann. Sec. 7401(3)2.(a)(4) and (9); R. I. Gen. Laws Sec. 44-11-14; S.C. Code Ann. Sec. 12-7-1120, 12-7-1140; Tenn. Code. Ann. Sec. 67-4-810(e)(1), 67-4-811(a); Utah Code Ann. Sec. 59-7-310, 59-7-311; Vt. Stat. Ann. Title 32, Sec. 5833(a); Va. Code Sec. 58-1-408; W.V. Code Sec. 11-24-6(c)(10)(B); Wisc. Stat. Ann. Sec. 71.25(5)(a)(6).

AUG 16 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-54

IN THE

Supreme Court of the United States

October Term, 1989

NCR CORPORATION,

Petitioner,

vs.

COMMISSIONER OF REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF MINNESOTA

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Where the application to a taxpayer of a 3-factor apportionment formula results in a difference in tax which is less than 23%, does the due process or commerce clause require that the property, payroll or sales factors of Petitioner, a Minnesota corporate taxpayer, include the property, payroll or sales of foreign subsidiary corporations from which it receives dividend or royalty income?

PARTIES INVOLVED

Petitioner is a Maryland corporation doing business in Minnesota. Respondent is the Commissioner of Revenue of Minnesota. Respondent is responsible for administration and enforcement of Minnesota's corporate tax.

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NCR CORPORATION,

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COMMISSIONER OF REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF MINNESOTA

BRIEF IN OPPOSITION

The respondent Minnesota Commissioner of Revenue respectfully requests that this Court deny the petition for Writ of Certiorari seeking review of the decision of the Supreme Court of Minnesota in this case. The opinion of the Minnesota Supreme Court is reported at 438 N.W.2d 86 (Minn. 1989) and is reproduced in Appendix A to the Petition at 14a-32a (hereinafter referred to as "Pet. App.").

STATEMENT OF THE CASE

Petitioner is a Maryland corporation which transacts business partly within and partly outside of Minnesota. During the relevant tax years it received royalty and dividend income from foreign subsidiaries engaged in a unitary business with Petitioner. Those foreign subsidiaries file no returns in Minnesota and Minnesota does not tax them on the income they earn because they do no business in Minnesota. Minnesota does, however, tax Petitioner on its income, which includes the dividends and royalties it receives as payee from the payor foreign subsidiaries. For the five tax years at issue (1977-1981) Respondent therefore included in apportionable income dividends and royalties received by Petitioner from foreign subsidiaries which Petitioner had excluded from income in its returns as filed. Respondent's inclusion of dividends and royalties and also other income items not appealed from yielded an assessment of additional taxes for the five tax years 1977-1981 of approximately $216 thousand.

In its appeal to the Minnesota Tax Court from the assessment, Petitioner objected to inclusion of the dividend and royalty[1] income on the ground that it was not engaged in a unitary business with its foreign subsidiaries. Notice of Appeal, Pet. App. p. 40a.

Petitioner later abandoned this ground, conceded that it was engaged in a unitary business with its subsidiaries, Tax Court Finding of Fact ¶ 6, Pet. App. p. 20a, and reverted to an alternative ground for opposing the assessment which had been stated in its notice of appeal to the Tax Court. That

[1] There has never been any issue concerning interest income received by NCR from subsidiaries in this appeal. *See* Reasons For Denying The Petition § II.

ground was that various adjustments should be made to the property/payroll/sales factors of the Minnesota apportionment formula. Notice of Appeal, Pet. App. p. 40a.

Before the Minnesota Supreme Court, Petitioner made no specific proposals for adjustments but rather made a request for some unspecified "correlative adjustment" to its factors. *NCR Corp. v. Comm'r of Revenue*, 438 N.W.2d 86, 91 n.6 (Minn. 1989), Pet. App. pp. 23a-24a. Petitioner has never, at any stage of the appeal, provided a tax recalculation premised on its theory of how the factors should be adjusted which would identify how much its "correlative adjustment" would reduce the assessment. The tax impact of apportioning the dividend and royalty income was to increase Respondent's tax an average of 23% for the five year period at issue. *NCR*, 438 N.W.2d at 93, Pet. App. p. 28a. Because including the dividend and royalty income increased Petitioner's tax only 23%, any change resulting from a factor adjustment could not exceed that amount and is very likely substantially less.

REASONS FOR DENYING THE PETITION

Petitioner does not contend that the Minnesota decision conflicts with any decision of this or any other court. Instead, Petitioner seeks review under Supreme Court Rule 17.1(c), asserting that the case presents an important question of federal constitutional law. Petitioner further asserts that this issue affects many taxpayers, involves large amounts of income and has not been uniformly dealt with by State courts.

Petitioner's contentions are groundless and certiorari should be denied.

I. THE QUESTION PRESENTED IS NOT AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN BUT SHOULD BE DECIDED BY THIS COURT.

A. There Is No Lack Of Uniformity In State Court Decisions On The Issue Presented Nor Are The States Misapplying The *Container* External Consistency Test.

The argument in favor of granting certiorari first presented by Petitioner at pp. 10-13 and later revisited as an external consistency argument at pp. 20-23 is that if foreign dividends and royalties from unitary subsidiaries are apportioned then some unspecified "correlative adjustments" must be made to the factors of the recipient. This question Petitioner represents to be an important question of state taxation not previously resolved by this Court. It indeed has not been expressly resolved. Respondent disagrees, however, with the suggestion of Petitioner contained at pp. 10-13 that the Court "deliberately" left it unresolved or somehow reserved it for consideration in a future case. There never has been a

need to resolve it[2] and Petitioner has not demonstrated that there is a need to do so now.

Petitioner's primary assertion is that the issue is one on which states are not taking a uniform approach. It is noteworthy that Petitioner makes no claim that state courts have reached inconsistent conclusions on the issue presented. Even in this claim of "nonuniformity," however, Petitioner is wrong. What the very decisions cited at pp. 15-16 of the Petition show is that the States are taking a uniform approach. Their analysis is the same. They are simply reaching different conclusions depending on what the facts of the case show to be the amount of potential distortion occurring from application of the formula to the circumstances of the taxpayer.

Maryland, Wisconsin and Minnesota are all applying the external consistency test described in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983) which requires that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Container*, 463 U.S. at 169. The states are further recognizing the rule of this Court that since no apportionment formula is perfect, a "substantial margin of error" is afforded apportionment formulas. *Container*, 463 U.S. at 183-84. In *Container* the Court described a potential distortion of 14% to be a "far cry" from the 250% distortion arising from a one factor formula in *Hans Rees' Sons, Inc.*

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[2] In the cases mentioned by Petitioner, the issue was indeed referred to. There never has been a need to resolve it, however. The issue had not been previously raised in *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980). The facts did not present it in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). The cases were decided on other grounds in *ASARCO Inc. v. Idaho State Tax Comm'r*, 458 U.S. 307 (1982) and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982).

v. North Carolina ex rel. Maxwell, 283 U.S. 12 (1931). *Container*, 463 U.S. at 184. *Hans Rees'* is the only case in which the Court has found impermissible distortion arising from an apportionment formula. The analysis of the states is the same. They are reaching different results on different facts.

In the Wisconsin case *American Telephone & Telegraph Co. v. Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 (Ct. App. 1988) the court held that on the facts of that case the formula did "not bear a reasonable relation to corporate activities"[3] of the taxpayer in Wisconsin and that the taxes were "grossly disproportionate to the benefits conferred"[4] by Wisconsin where the effect of including the income was by itself to increase apportionable income five times over that of the previous year (from $500 million to $3 billion).[5]

The Maryland Court of Appeals, in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d 764 (1988), determined that the Maryland apportionment formula as applied to NCR should be modified *if* distortion of constitutional dimensions exists. The case was remanded for fact finding on the amount of possible distortion.

The Minnesota Supreme Court in its opinion in the instant case made the same type of *Container* analysis. It concluded on the facts that the distortion which could be argued to result from the Minnesota formula was not of a size to be constitutionally objectionable. *NCR*, 438 N.W.2d at 93, Pet. App. pp. 27a-28a. The exact amount of the alleged distortion resulting from Minnesota's refusal to adjust Petitioner's factors is, of course, not known since Petitioner never pro-

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[3] *American Telephone & Telegraph Co. v. Wisconsin Dept. of Revenue*, 143 Wis.2d 533, 422 N.W.2d 629 at 636 (Ct. App. 1988).

[4] *Id.*

[5] *Id.*, 422 N.W.2d at 634.

vided to the Minnesota Supreme Court a specific correlative adjustment proposal nor a tax recalculation premised on it. Respondent asserts there is no distortion at all. However, the *total* effect of *including* the dividend and royalty income in apportionable income with *no* factor adjustment was approximately 23%. The effect of failing to adjust the factors as Petitioner desires must be even less than that (substantially less, Respondent suspects). If the Minnesota formula can be said to result in distortion, surely, a level of distortion of less than 23% is constitutionally permissible. Petitioner at p. 10 n.6 suggests 40 or 50%. Even were it as high as 50%—a figure rejected by the Minnesota Supreme Court, *NCR*, 438 N.W.2d at 93, Pet. App. pp. 27a-28a,[6]—this is still insubstantial because it is a far cry from the 250% rejected in *Hans Rees'*.

Consequently, Petitioner's assertion of a lack of uniformity does not withstand analysis.

Petitioner argues at pp. 20-23 of the Petition that the fact-based approach used by Minnesota, as well as Wisconsin and Maryland, to measure whether the potential difference in taxes exceeds a constitutionally acceptable level is improper. It asserts that the Minnesota formula is structurally or conceptually defective. Each of the reasons Petitioner advances in support of this proposition is fallacious.

First, Petitioner argues that Justice Stevens' dissent in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 449-62 (1980), establishes that inclusion of dividends from foreign subsidiaries in apportionable income without inclusion of the subsidiaries' property, payroll and sales in the formula vio-

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[6] It was rejected because it was based on a number of faulty premises. For example, Petitioner includes interest income in the calculation even though no interest income issue was raised in its Notice of Appeal. *See* Pet. App. p. 40a.

lates the external consistency requirement. On the contrary, Justice Stevens' language in *Mobil* is consistent with the State's fact-based approach to this issue. Justice Stevens' dissent must be understood in the context of the facts of the case, in which he observed that in his view "Vermont indefensibly used its apportionment methodology artificially to multiply its share of Mobil's 1970 taxable income perhaps as much as tenfold." *Mobil*, 445 U.S. at 461. In this context he wrote in a dissenting opinion that:

> Unless the sales, payroll and property values connected with the production of income by the [dividend] payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

Mobil, 445 U.S. at 461. He was not opining that in *all* cases the standard three factor formula is defective and must be restructured if foreign source income is apportioned. If it were compelled in all cases, the Court would be specifying one formula for use by all states contrary to the firmly established policy of the Court that "the Constitution imposes no single formula on the States," *Container*, 463 U.S. at 164, and contrary to the policy of wide latitude afforded states in structuring their formulas, *see Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (one factor formula upheld).

Second, there is surely no "conceptual inconsistency," as suggested by Petitioner at p. 22 of the Petition, in Minnesota's formula because it does not include in the factors of a Minnesota taxpayer the property, payroll and sales of other corporations which do no business in Minnesota and file no returns in Minnesota. As observed by both the Minnesota Court, *NCR*,

438 N.W.2d at 92, Pet. App. p. 25a, and the Maryland Court of Appeals in *NCR Corp. v. Comptroller of the Treasury*, 313 Md. 118, 544 A.2d at 772, this "consistency" contention is premised on confusion over who and what is being taxed. Minnesota is not taxing the income earned by the foreign subsidiaries. It is only taxing income (dividends and royalties) earned and received by Petitioner. It makes no conceptual sense to require inclusion, in Petitioner's apportionment formula, of factors of corporations whose income is not being taxed. To include them merely expands the denominator of the formula, distorting it.

Third, in support of its consistency argument Petitioner suggests at p. 21 that Minnesota's method must be invalid because Petitioner's apportionable income would be changed were it to operate through branches of the parent corporation in foreign countries rather than independent subsidiary corporations. This is surely no revelation demonstrating a deficiency in the Minnesota formula. The form of corporate organization chosen by a taxpayer does have tax consequences. Indeed, the method of corporate organization is often solely intended to achieve certain tax purposes.

The very example suggested by Petitioner—of a corporation doing business itself in a foreign country (through a branch) compared with one having a subsidiary in the foreign country—gives proof to this point. If the corporation chooses the former method of corporate organization (doing business itself through a branch rather than setting up a subsidiary), Minnesota would tax the appropriate portion of *all* the income earned by the corporation, including that income earned by the branch in the foreign jurisdiction. If the corporation chooses the latter form of organization (as has Petitioner), Minnesota would include in apportionable income, and therefore tax, only

such distributions as actually were made to the parent corporation. It would not tax the underlying income earned by the subsidiary in the foreign jurisdiction. By choosing to separately incorporate its foreign subsidiaries, Petitioner has shielded their foreign income from Minnesota taxation. Petitioner should not be allowed to have its cake and eat it too by being allowed to reshape the apportionment formula to include its subsidiaries' factors.

B. The Question Presented Does Not Have The Significance Which Petitioner Suggests.

Petitioner asserts at pp. 13-14 of its Petition that the question presented affects taxpayers in nearly every state and many local jurisdictions and involves billions of dollars of foreign source earnings. The facts and data it offers in support of the statement show no such thing.

Petitioner asserts an effect on numerous taxpayers because of an alleged "common practice" to apportion foreign source income without somehow adjusting the factors. The very decisions cited by Petitioner show the contrary. The taxpayer in the Wisconsin case prevailed and the Department of Revenue was ordered to determine a formula that would achieve constitutional results, although the request for the particular factor adjustment requested by AT&T was rejected by the Court. *AT&T*, 143 Wis.2d 533, 422 N.W.2d at 636-39. NCR in the Maryland case will get a factor adjustment if it proves significant distortion. The Minnesota Court did not rule one out in a case of significant distortion. The decisions show that adjustments are being ordered where appropriate.

At least one state provides factor adjustments by statute[7] when foreign source dividends are apportioned. Moreover, most states have a statute similar to Minn. Stat. § 290.20, subd. 1 (1988) which provides:

> The methods prescribed by section 290.191 shall be presumed to determine fairly and correctly the taxpayer's taxable net income allocable to this state. If the methods prescribed by section 290.191 do not fairly reflect all or any part of taxable net income allocable to this state, the taxpayer may petition for or the commissioner may require the determination of net income by the use of another method, if that method fairly reflects net income. These other methods may include:
>
> (1) separate accounting;
>
> (2) excluding any one or more of the factors;
>
> (3) including one or more additional factors; or
>
> (4) some other method.
>
> . . . .

Section 18 of the Uniform Division of Income for Tax Purposes Act (UDIPTA) and Multistate Tax Commission Compact art. IV, § 18 are nearly identical. Respondent believes that the states do consider factor adjustments under such statutes to deal with circumstances where applications of the regular formula would yield a distorted result and not be fair.

The statement at p. 14 of the Petition that there are many state disputes involving the issue presented and the statement at p. 16 that the Court should address the issue to avoid widespread administrative and judicial proceedings is belied by the fact that in the eight years since Justice Stevens' dissenting opinion in the *Mobil* case, only three state cases on this

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[7] *See* Utah Code Ann. § 59-7-303(4) (1987).

constitutional issue have been litigated—the instant case, and the two cited on p. 15 of the Petition. However interesting the issue may be to Petitioner, who evidently has filed appeals on the issue in 44 states, it cannot be said to have been a subject generating a great deal of litigation. Consequently, Petitioner's generalities about common practices and their effects on taxpayers in a number of states do not withstand scrutiny.

The actual data offered by Petitioner to suggest that the magnitude of the impact of the question presented is billions of dollars is misleading in several respects. First, it does not show the tax impact of the issue presented. Petitioner has not presented any data showing the amount by which taxes will be reduced if correlative adjustments are allowed. Petitioner instead offers aggregate amounts of receipts of dividends, interest and royalties from U.S. controlled foreign corporations. Petition pp. 13-14 n.7. The propriety of including the income is conceded by Petitioner and is not at issue. Factor adjustments are at issue. Petitioner never, however, offers data on the tax impact of requiring factor adjustments, either in the form of aggregate data or in the form of a tax recalculation on the facts of the instant case.

Taking the example of the instant case, Respondents believe the effect is minimal. The total effect of apportioning Petitioner's dividends and royalty income for all of the 1977-1981 tax years was to increase its tax only about 23%. And, it must be remembered, the effect of adjusting factors has to be even less than the effect of including the foreign source income itself. Petitioner asserts at p. 10 n.6 that the number is 40% in 3 of 5 years and 50% in one year by including interest income in its calculation which type of income is not at issue. Even were the number as high as 50%, which again is not the impact of Petitioner's unspecified factor adjustments but is rather the tax impact of apportioning the income, such a

number is still within the permissible margin of error for a formula.

In addition to the fact that Petitioner's data does not address the question presented, the data offered is misleading because it overstates the magnitude of the question in several ways. First, much of the dividend income is not taxed by the states. Petitioner alludes to 1980 IRS data showing approximately eleven billion dollars in dividends paid in 1980 by controlled foreign subsidiaries to U.S. corporations. However, not all states tax foreign source dividends. Eleven states[8] exempt foreign source dividends from taxation and 19 more states[9] substantially exempt them.[10] Minnesota itself gave an

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[8] *See e.g.* Ariz. Rev. Stat. Ann. § 43-1122(8) (Supp. 1988); Conn. Gen. Stat. Ann. § 12-217(a)(D) (West 1983); Del. Code Ann. tit. 30 § 1903(a)(2) (1985); Fla. Stat. Ann. § 220.13(1)(b)2a (West 1989); Ga. Code Ann. § 48-77-21(b)(8) (Supp. 1988); Ky. Rev. Stat. Ann. § 141.010(12)(b) (Michie/Bobbs-Merrill Supp. 1988); Mo. Rev. Stat. § 143.431 (Supp. 1989); Neb. Rev. Stat. § 77-2716(3) (1986); Ohio Rev. Code Ann. § 5733.04(I)(2) (Page's Supp. 1988); Pa. Rev. Stat. Ann. tit. 72 P.S. § 7401(3)1(a)&(b) (Purdon's Supp. 1989); W. Va. Code § 11-24-6(c)(10) (Supp. 1988).

[9] *See e.g.* Ark. Stat. Ann. §§ 26-51-404, 26-51-707 (1987); Cal. Rev. & Tax Code § 24411 (Supp. 1989); Col. Rev. Stat. §§ 39-22-304, 39-22-303(10) (Cum. Supp. 1988); Idaho Code § 63-3027C (1989); Ill. Rev. Stat. Ann. Ch. 120 para. 2-203(b)(2) (Smith-Hurd 1974); Ind. Code Ann. § 6-3-2-12 (West 1989); Kan. Stat. Ann. § 79-32,138 (c)(iv) (Cum. Supp. 1988); Md. Tax-Gen. Code Ann. § 10-307(b) (1988); Mass. Gen. Laws Ann. ch. 63 § 38(a) (West 1988); Minn. Stat. § 290.21 Subd. 4 (1988); Mont. Code Ann. § 15-31-325 (1987); N.J. Rev. Stat. § 54:10A-4(k) (1986); N.Y. Tax Law § 208.9(a)(1) &(2) and (b)(2)&(3) (McKinney 1986); N.D. Cent. Code § 57-38-01.3 (Supp. 1989); Or. Rev. Stat. § 317.267 (1983); Tenn. Code Ann. § 67-4-809 (1983); Utah Code Ann. §§ 59-7-106(2)(d), 59-7-303(1) (1987); Va. Code Ann. §§ 58.1-402C, 58.1-302 (Supp. 1989); Wis. Stat. Ann. § 71.04(4) (West 1989).

[10] Even the chart presented in Petitioner's Appendix (pp. 48a-50a) shows that 21 states do not tax dividends at all or exclude them from apportionable income. Many states that do tax them provide deductions for dividends paid by affiliates. *See* Pet. App. p. 50a n.2.

85% credit (exemption) for the tax years at issue. *See* Minn. Stat. § 290.21, subd. 4 (1980). Many other states give an exemption of similar magnitude.[11]

Second, the data offered overstates the tax impact of the issue presented because it includes more than income received by U.S. corporations from unitary foreign subsidiaries. The IRS data is on all controlled corporations whether or not they are corporations unitary with a U.S. parent. *See* 26 U.S.C.A. § 957(a) (1988). Whether a corporation is unitary with its parent depends on facts unique to each parent and subsidiary. Similarly, the Commerce Department data, Petition pp. 13-14 n.7, is not data on foreign source income paid by unitary foreign subsidiaries to U.S. parents. Like the IRS data, it is more inclusive than data on foreign source income paid to U.S. parents by unitary subsidiaries. The data consists of aggregate data on any U.S. company having investments abroad amounting to more than a 10% shareholder interest whether in a unitary foreign subsidiary or not. 15 C.F.R. ch. VIII, § 806.14(a) (1988). Therefore since the data presented is not limited to data on foreign source income received by U.S. corporations from unitary foreign subsidiaries it overstates the significance of Petitioner's issue.[12]

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[11] *See e.g.* Idaho Code § 63-3027C (1989); Ill. Rev. Stat. Ann. ch. 120 para. 2-203(b)(2) (Smith-Hurd 1974); Ind. Code Ann. § 6-3-2-12 (West 1989); Or. Rev. Stat. § 317.267 (1983).

[12] The Commerce Department data also overstates the magnitude of the tax issue in the instant case in other ways. Petitioner cites that data to show an aggregate $27.73 billion in dividends, interest and royalties paid in 1987 by foreign affiliates to domestic parents. First, "distributed earnings" (which includes dividends) represent $19 billion of this amount, which as observed above is completely or substantially exempt from taxation in many states. Second, what Petitioner characterizes as dividends is really presented in the data as "distributed earnings." U.S. Department of Commerce, Bureau of Economic Analysis, Survey of Current

Respondent submits therefore that Petitioner has made no attempt to identify the monetary impact of the actual tax issue presented (factor adjustments). Further, because of exemptions in many states of what is clearly the biggest income item (dividends) and deficiencies in the data which it does present, the tax impact of the issue presented is surely substantially less significant than intimated by Petitioner.

C. The Due Process Internal Consistency Analysis Presented By Petitioner Is Flawed.

At pages 18-20 of the Petition it is asserted under the *Container* due process internal consistency test that it is a *mathematical certainty* that not adjusting factors inevitably results in more than all of Petitioner's income being taxed. Petitioner is wrong in both its legal analysis and its mathematics.

The legal analysis is flawed because Petitioner has misapplied the internal consistency analysis. To be internally consistent, the apportionment formula must not result in more than all of a unitary business's income being taxed if applied by every jurisdiction. In *Container*, the Court described the test:

> The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if

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Business, Vol. 68, number 6, 55 at line 5 (June 1988) and Vol. 69, number 3, 46 (March 1989). Distributed earnings is not limited to dividends but rather also includes such payments as distributions from partnerships and trusts and resulting profits of any type including those arising from ownership of commercial real estate and unincorporated businesses. *See* 15 C.F.R. ch. VIII, § 806.7(i) (j) and (k) (1988) (defining types of investment covered by data).

> applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed.

Container, 463 U.S. at 169. The formula, in other words, must not result in multiple taxation of the same income by different jurisdictions. Petitioner and Respondent differ on what the relevant taxing "jurisdictions" are under this test.

Petitioner apparently argues that the internal consistency requirement is violated if multiple taxation occurs as a result of taxes imposed by foreign nations. Respondent's position is that the U.S. Constitution can only mandate internal consistency among the taxing jurisdictions within the United States.

Petitioner contends that it is subject to tax in jurisdictions in which it does business (which it calls NCR jurisdictions) and also subject to a tax by what it calls Foreign Jurisdictions on the dividends and royalties which it expatriates to the United States. An example is a tax charged by Canada which is described at p. 26 n.15 of the Petition as an income withholding tax imposed on NCR.[13] Petitioner contends that use of the Minnesota apportionment formula, as applied here, in all "NCR jurisdictions," combined with taxation of the same foreign source income by the foreign jurisdictions would inevitably result in multiple taxation. That contention is irrelevant for internal inconsistency purposes.

Petitioner's construction of the internal consistency test cannot be correct, because it would be impossible to satisfy. The internal consistency test requires that a formula, if applied by *all jurisdictions*, would not cause multiple taxation.

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[13] *See* Income Tax Act of Canada §§ 212(1)(b), 212(1)(d), 212(2) which imposes a tax on dividends paid a nonresident by a Canadian corporation, which tax is withheld by the Canadian corporation.

The Minnesota apportionment formula[14] assures that if all *states* apportion a taxpayer's income on that basis, 100%, but no more than 100%, of the income would be taxed. However, if taxation of the same income by foreign jurisdictions, not subject to the strictures of the U.S. Constitution, is also considered, it is an impossibility to guarantee that multiple taxation will not occur. In fact, if taxation by all states and even one foreign jurisdiction is assumed, multiple taxation is, as posited by Petitioner, a virtual certainty.[15] Plainly, the Court cannot have intended its internal consistency test to be one that can never be satisfied. Accordingly, evaluation of an apportionment formula for internal consistency must necessarily take only state taxation into account, excluding consideration of the potential impact of foreign taxation.[16]

Indeed, the only way to insure that no multiple taxation could result from the combined effect of taxation by the states as well as foreign jurisdictions would be to prohibit taxation of foreign source income entirely. The Court has already rejected that approach in *Mobil* and *Container*. Respondent

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[14] Income of taxpayer x

$$\frac{\text{Taxing state property/payroll/sales of taxpayer}}{\text{Total property/payroll/sales of taxpayer}}$$

[15] This is so even if the foreign subsidiary's property/payroll/sales are included in the denominator of the formula, because use of the formula by all states would result in 100% taxation. The foreign jurisdiction, unencumbered by the strictures of our Constitution, remains free to tax any or all of the same income paid by the foreign subsidiary.

[16] Respondents observe that even if the internal consistency test were applied to foreign taxing jurisdictions, the Minnesota formula would pass the test. If it were assumed that the relevant taxing jurisdictions consisted of the states and also all foreign jurisdictions and that if the inquiry was whether if all of these jurisdictions used the Minnesota formula multiple taxation would occur, the answer would clearly be no. Under the Minnesota formula it would be impossible.

observes in this vein that Petitioner has been careful to make no attempt to describe how and why its correlative adjustment will remedy what it perceives to be an internal consistency problem.

By attempting to inject the effect of foreign jurisdiction taxation into the internal consistency analysis, Petitioner is really objecting to international multiple taxation, about which the internal consistency test can say nothing. More properly, Petitioner's analysis of the effect of combined state and foreign taxation should be made under the foreign conmerce clause. Indeed Petitioner does at pp. 23-27 of the Petition (discussed below in section I.D.) make the very same argument as a foreign commerce clause argument. Petitioner's legal analysis in which it attempts to shoe-horn that argument into the internal consistency test is, however, fatally flawed.

Just as with Petitioner's le[illegible]l analysis, its mathematics are flawed. Even were we to accept its contention as a legitimate internal consistency analysis, Petitioner's failure to include in its calculation the federal foreign tax credit should invalidate its approach. The federal returns of NCR show it received a credit on its federal income tax return on most if not all of the taxes it paid foreign governments on foreign source income it received. *See* I.R.C. § 901, 26 U.S.C.A. § 901 (Supp. 1989) (foreign tax credit). The returns of NCR contained in the case record show that it included the tax which it paid Canada in its calculation of the foreign tax credit. *See e.g.* 1980 federal return, Form 1118 (and supporting schedules) and Form 1120 Schedule J. Petitioner's mathematics are therefore to be rejected since such actual double taxation which hypothetically might exist is eliminated by the federal foreign tax credit.

D. The Foreign Commerce Clause Argument Of Petitioner Was Effectively Rejected By This Court In *Mobil* And *Container*.

At pp. 23-27 of the Petition it is asserted that the foreign commerce clause is violated unless Minnesota makes some correlative adjustment to its statutory formula. It is asserted that international double taxation otherwise results because foreign countries have a primary right to tax dividends and royalties paid to a nonresident. The income withholding tax imposed by Canada on dividends and royalties paid by the Canadian subsidiary is given as an example at p. 26.

Respondent submits that this argument was rejected *a fortiorari* in *Mobil* and *Container* where the Court rejected foreign commerce clause arguments opposing inclusion of foreign source income in apportionable income. Because the factor adjustments proposed by Petitioner are issues involving a tax impact which is necessarily less than the impact of apportioning the income itself the issue presented has even less foreign commerce significance than the issue decided against the taxpayers in *Mobil* and *Container*. Petitioner's argument should therefore be considered included in the arguments rejected in *Mobil* and *Container*.

In both *Mobil* and *Container*, the taxpayers sought to extend the holding of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), concerning a property tax levied on containers used in foreign commerce, to an income-based tax. This Court refused to do so in *Mobil*, where the taxpayer asserted that taxation of foreign source dividends should be restricted to the taxpayer's domestic domicile lest double taxation result because of taxes levied by foreign countries. The Court similarly rejected in *Container* a foreign commerce clause challenge to California's worldwide formulary apportionment tax-

ation of foreign subsidiaries. The argument was that double taxation of the income of the foreign subsidiaries would result if California apportioned part of the income of those subsidiaries to the parent, because the income of the subsidiaries was taxed under separate accounting (100% taxation, non-apportioned) in their home (foreign) jurisdictions.

The Court in *Mobil* observed that "the factors favoring use of the [international] allocation method in property taxation have no immediate applicability to an income tax." *Mobil*, 445 U.S. at 448. Again in *Container* the Court refused to extend the holding of *Japan Line* to an income-measured tax, finding that there are significant differences between income-based and property taxation for foreign commerce clause purposes. *Container*, 463 U.S. at 187-88.

Foreign commerce clause arguments were rejected in both of these income tax cases for very practical reasons; to wit, since this Court has no control over foreign governments it cannot assure that double taxation may not occur by reason of their actions in the way it can assure that the actions of the various states do not result in double taxation.

The foreign commerce clause should therefore provide Petitioner no solace in the instant case. Consistent with this, how and why a correlative adjustment (whatever it may be) will prevent international double taxation is not revealed by Petitioner. The only way to assure against double taxation is to prevent taxation of foreign source income entirely—a result rejected in *Mobil* and *Container*. Multiple taxation is no more inevitable in the instant case than in *Mobil* or *Container* and logically is *less* since the correlative factor adjustment Petitioner has in mind will surely have less impact on tax paid than including the income itself (the issue in *Mobil* and *Container*).

At p. 27 of the Petition it is asserted that Minnesota's failure to adjust Petitioner's factors prevent the United States from speaking with one voice in regulating foreign commerce. Petitioner offers no evidence at all of any federal policy with which the Minnesota Supreme Court opinion is in conflict. This is consistent with the express rejection of the taxpayer's similar argument in *Container*. *See Container*, 463 U.S. at 193-97.

The proffered foreign commerce clause question was therefore effectively resolved by this Court's opinions in *Mobil* and *Container* and is not one on which this Court need rule in this case.

II. THE RECORD IN THIS CASE DOES NOT SUFFICIENTLY PRESENT THE ISSUE RAISED BY PETITIONER.

The deficiencies in the record are several. First, Petitioner has proposed neither to the Minnesota Supreme Court nor to this Court a specific proposal for the "correlative adjustment" which it seeks. Moreover, Petitioner has never provided any tax recalculation under the method of adjusting the factors it proposes. The Minnesota Supreme Court itself commented on this deficiency in its opinion:

> In its brief and at oral argument, relator was unable to more precisely define what it contended should be included in this "correlative adjustment." During the course of this proceeding, NCR has seemingly shifted its position on this issue, lending some support, in our view, to the Commissioner's contention that selection of an apportionment formula is essentially one of policy for legislative resolution.

NCR, 438 N.W.2d at 91 n.6, Pet. App. pp. 23a-24a. If this Court should ever take up this issue, which Respondent believes is unlikely for the reasons stated above, it should do so on a more complete factual record dealing with specific proposals for adjusting a state's formula.

The second deficiency in the record is that although Petitioner in the question presented refers to interest received from foreign sources as part of that which is in issue, foreign source interest has *never* been an issue in this case and cannot therefore become one now. The Notice of Appeal of Petitioner to Tax Court raises no issue at all concerning foreign source interest. *See* Pet. App. p. 40a. This is reflected in the Tax Court's Statement of the Issue which refers only to dividends and royalties. *See* Pet. App. p. 6a. Petitioner concedes so. Petition pp. 7-8 n.5. The Minnesota Supreme Court similarly observed interest was not in issue and confined its discussion to dividends and royalties. *NCR*, 438 N.W.2d at 87 n.1, Pet. App. p. 16a. The statement in footnote 5 of the Petition that the case was somehow "presented" to the Minnesota Supreme Court on the interest issue cannot possibly be true. Amounts of interest were stipulated to as matters of fact. The Notice of Appeal, however, defines and limits the issues raised to dividends and royalties.

Third, Petitioner has asserted as part of its internal consistency argument at p. 19 n.11 of the Petition that it paid approximately $41.5 million in foreign withholding taxes, such as those it paid Canada. This amount is also alluded to at p. 3 n.2 of the Petition in which Petitioner asserts that these amounts were "derived" from federal income tax returns attached to the Minnesota returns which were part of the stipulated record. There are no findings of fact supporting

this amount or any other amount of foreign withholding taxes paid. That amount does not appear on the face of the returns. How it was derived by Petitioner is not at all clear. The record is thus inadequate in establishing the amount of withholding taxes paid.

CONCLUSION

For the foregoing reasons the Petition should be denied.

Respectfully submitted,

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No. 89-54

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

NCR CORPORATION,

Petitioner,

v.

COMMISSIONER OF REVENUE OF MINNESOTA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

REPLY BRIEF

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RULE 28.1 STATEMENT

A Rule 28.1 Statement is made in the Petition for a Writ of Certiorari and is still accurate.

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NCR CORPORATION,

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COMMISSIONER OF REVENUE OF MINNESOTA,

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ON PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA SUPREME COURT

REPLY BRIEF

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1. **Inevitable international multiple taxation.** Respondent concedes (Br. Opp. 16-18)[1] for the first time in this litigation that the Minnesota apportionment formula results in international multiple taxation of Petitioner's foreign-source dividends, interest,

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[1] "Br. Opp." references are to Respondent's Brief in Opposition. "Pet." references are to the Petition for a Writ of Certiorari.

and royalties.[2] This concession firmly establishes the appropriateness of granting certiorari. As is discussed in the Petition, such international multiple taxation violates both the internal consistency requirement of the Due Process and Commerce Clauses (Pet. 18-19) and the Commerce Clause restrictions on state taxation of foreign commerce (Pet. 23-27).

In an attempt to avoid the obvious ramifications of his admission that the Minnesota apportionment formula results in international multiple taxation, Respondent argues that the internal consistency test applies without reference to foreign taxes. (Br. Opp. 16-18) This construction of the internal consistency

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[2] Respondent suggests, also for the first time, that this international multiple taxation is then eliminated by the federal foreign tax credit. (Br. Opp. 18) This suggestion makes absolutely no sense since the foreign tax credit reduces federal income taxes, not state income taxes.

Respondent also challenges whether the record supports Petitioner's statements describing the foreign taxes it paid with respect to its foreign-source dividends, interest, and royalties. (Br. Opp. 22-23) These amounts, however, are set out on schedules and statements supporting the Forms 1118 and 1120 of Petitioner's federal income tax returns. These portions of the federal income tax returns are attached to Petitioner's Minnesota returns, which were offered and received in evidence in the Minnesota Tax Court and included in the record transmitted to the Minnesota Supreme Court.

In any event, Minnesota's right to tax Petitioner's foreign-source dividends, interest, and royalties on an apportioned basis does not depend on the extent to which the foreign countries choose to exercise their primary right to tax these items. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980). Thus, Respondent's assertions as to deficiencies in the record are both factually wrong and legally irrelevant.

test is contrary to the application of that test by this Court in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983). In *Container*, this Court took foreign taxes into account in applying the internal consistency test.

Respondent nonetheless argues (Br. Opp. 16) that application of the internal consistency test with reference to foreign taxes "cannot be correct, because it would be impossible to satisfy." Respondent thus acknowledges that the Minnesota apportionment formula does not satisfy the internal consistency test if the foreign taxes paid by Petitioner on its foreign-source dividends, interest, and royalties are taken into account as they were in *Container*. The test would be satisfied, however, if the formula were modified either by excluding the foreign-source dividends, interest, and royalties from apportionable income or by correlatively adjusting the apportionment factors to take into account the payroll, property, and sales of Petitioner's foreign unitary subsidiaries.[3]

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[3] Respondent repeatedly chides Petitioner for not clarifying how the apportionment factors in this case should be correlatively adjusted. (Br. Opp. 3, 4, 7, 18, 21) But Petitioner does not contend, as Respondent suggests (Br. Opp. 8), that there is only one constitutionally acceptable way to correct the Minnesota apportionment formula. Petitioner's position consistently has been only that the Minnesota apportionment formula, *as applied and upheld below*, is unconstitutional. It is true "bootstrapping" to suggest that this unconstitutionality should be permitted to continue because the aggrieved taxpayer has not solved the problem. It is Minnesota's responsibility, in the first instance, to correct its formula by choosing among a variety of options (including the exclusion of the foreign-source items from apportionable income or an adjustment of the apportionment factors). This Court need only decide whether it is unconstitutional for Minnesota to

In any event, Respondent does not challenge (Br. Opp. 19-21) the relevance of international multiple taxation when considering Commerce Clause restrictions on state taxation of foreign commerce. Instead, Respondent (Br. Opp. 19) "submits that this argument was rejected *a fortiorari* in *Mobil* and *Container* where the Court rejected foreign commerce clause arguments opposing inclusion of foreign-source income in apportionable income."

Respondent's reliance on *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), and *Container* is clearly misplaced. *Mobil* involved an entirely different "multiple taxation" argument. Mobil argued that all of its foreign-source dividend income was fully taxable by the State of commercial domicile and, therefore, any apportionment to Vermont unavoidably subjected Mobil to the risk of multiple taxation at the state level. In deciding this Commerce Clause issue against Mobil, this Court rejected Mobil's assumption that the dividends would necessarily be subject to full taxation by the State of commercial domicile. 445 U.S. at 445-446. In so doing, this Court noted that (445 U.S. at 447):

> By admitting the power of the State of commercial domicile to tax foreign-source dividends *in full*, Mobil necessarily forgoes any contention that local duplication of foreign taxes is proscribed.

Petitioner now makes that contention. Since Petitioner's foreign-source dividends, interest, and

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include dividends, interest, and royalties in apportionable income without adjusting the apportionment factors. Once that issue is resolved, the case may be remanded to the Minnesota Supreme Court for further proceedings.

royalties were subject to foreign withholding taxes, Petitioner contends (Pet. 23-27) that *any* state taxation (even by the State of commercial domicile) of these items is unconstitutional because it "creates more than the *risk* of multiple taxation; it produces multiple taxation in fact." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). Thus, contrary to Respondent's assertion, Petitioner's international multiple taxation argument goes beyond Mobil's and, therefore, was not dealt with by this Court.

Container also is distinguishable because, on the facts of that case, this Court concluded that international multiple taxation was not inevitable. See Pet. 26-27.

2. **External consistency test**. Petitioner has contended, relying on this Court's decision in *Mobil*, that the Minnesota apportionment formula is conceptually flawed since it causes Petitioner's Minnesota taxable income to increase solely as a consequence of conducting Petitioner's foreign operations in separately incorporated subsidiaries rather than in foreign branches. See Pet. 20-22. Respondent does not dispute the factual premise of Petitioner's argument, acknowledging (Br. Opp. 9), "The form of corporate organization chosen by a taxpayer does have tax consequences." Instead, Respondent defends this result, stating (Br. Opp. 10):

> By choosing to separately incorporate its foreign subsidiaries, Petitioner has shielded their foreign income from Minnesota taxation. Petitioner should not be allowed to have its cake and eat it too by being allowed to reshape the apportionment formula to include its subsidiaries' factors.

This statement evidences Respondent's misunderstanding of both Minnesota's taxing jurisdiction and this Court's decision in *Mobil*. As this Court has repeatedly recognized, a State may not tax income earned outside its borders. Consequently, Minnesota may not tax the income earned by the activities of Petitioner's foreign branches. The inclusion of such income in the apportionable base would be unconstitutional if the branches' payroll, property, and sales were not also included in the apportionment factors. Thus, by seeking a correlative adjustment to its apportionment factors if payments from its unitary foreign subsidiaries are included in the apportionable base, Petitioner is hardly seeking to have "its cake and eat it too." Petitioner is merely seeking to avoid being penalized as a consequence of its choice of corporate organization for its foreign activities. This Court should grant certiorari to determine whether Respondent's systematic increase in Petitioner's Minnesota taxable income solely as a result of Petitioner's choice of corporate form can be squared with its decision in *Mobil*.

In countering Petitioner's external consistency argument, Respondent relies principally on the factual contention that the average increase in Petitioner's tax as a result of apportioning dividends and royalties during the five years in issue (determined pursuant to this Court's methodology in *Container*) was 23 percent. Respondent further contends (also citing *Container*) that a 23 percent increase is not sufficiently significant to warrant any factor adjustment. (Br. Opp. 3, 7, 12-13)[4]

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[4] Respondent has even gone so far as to incorporate the 23

Respondent's reliance on *Container* in this fashion underscores the importance of granting certiorari. It is important for this Court to decide whether the amount of distortion is relevant, where, as Petitioner contends (Pet. 20-23), the Minnesota apportionment formula is conceptually flawed. This is an issue not settled by this Court in *Container* because, in *Container*, the apportionment formula was found to be conceptually sound.

If the Minnesota formula is conceptually indefensible, then the State of Minnesota cannot rely on *Container* as authority to systematically overtax Petitioner year after year simply because the increase in taxation does not exceed 23 percent. Use of such a flawed formula would inevitably overstate (as Justice Stevens recognized in his dissent in *Mobil*, 445 U.S. at 461) Petitioner's Minnesota taxable income, and it is no answer at all to suggest that this inevitable, systematic overstatement was *only* 23 percent. Just as this Court "need not know how unequal [a tax] is before concluding that it unconstitutionally discriminates" (*Maryland v. Louisiana*, 451 U.S. 725, 760 (1981)), this Court need not know how distortive or inherently unreasonable an apportionment formula is before concluding that it unconstitutionally taxes extra-territorial values.

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percent figure in his statement of the Question Presented (Br. Opp. i), suggesting that the amount of distortion is responsive both to the internal consistency argument and the Commerce Clause restrictions on state taxation of foreign commerce. To the contrary, having conceded (Br. Opp. 16-18) that international multiple taxation is present in this case, the Minnesota apportionment formula must be found unconstitutional in all events even if the distortion were held not to be violative of the external consistency test.

Finally, if the extent of distortion resulting from the Minnesota formula were constitutionally relevant (as Respondent contends), the distortion in this case, *as determined under the methodology of this Court in Container*, is far greater than an average of 23 percent as Respondent persists in asserting. Nor should there be any genuine dispute at all on this point despite Respondent's assertions.[5] This point is repeated in this Reply Memorandum because Respondent has chosen to make this issue so crucial in his Brief in Opposition.

We also reiterate the need for this Court to interpret its prior decisions in *Mobil* and *Container*. As is demonstrated by the Petition and the Brief in Opposition, *both* parties rely heavily on these decisions. There is an obvious need, therefore, for this Court to clarify how its prior decisions should be applied in cases such as this.

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[5] As discussed at Pet. 10 n. 6, Petitioner filed a Petition for Rehearing in the Minnesota Supreme Court showing (pp. 8-12) that the average percentage distortion under *Container* was 31 percent, not 23 percent, and that the distortion was 40 percent or more in three of the five years and 50 percent in one year. Furthermore, contrary to Respondent's assertion (Br. Opp. 7 n. 6, 12), these calculations only reflect a distortion by dividends and royalties, and any distortion caused by the inclusion of interest in apportionable income was *not* taken into account. *All* of the assumptions used were favorable to Respondent in order to clearly demonstrate, *as a purely legal matter*, that Respondent's 23 percent figure was *not* determined in accordance with this Court's opinion in *Container*. For the convenience of the Court and to forestall any possibility that Respondent's continued persistence in relying on the 23 percent figure will dissuade this Court from granting certiorari, the Petition for Rehearing has been lodged with the Clerk of the Court.

CONCLUSION

The petition for a writ of certiorari to review the judgment of the Minnesota Supreme Court should be granted.

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